

Hearing Date and Time: November 27, 2018 at 1:30 p.m. (Eastern Time)

Objection Deadline: November 27, 2018 at 1:30 p.m. (Eastern Time)

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Unsecured Creditors of Sears Holdings Corporation, et al.*

**UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK**

In re

SEARS HOLDINGS CORPORATION, et al.,

Debtors.¹

Chapter 11

Case No. 18-23538 (RDD)

(Jointly Administered)

**SUPPLEMENTAL OBJECTION OF THE OFFICIAL COMMITTEE OF UNSECURED
CREDITORS OF SEARS HOLDINGS CORPORATION, ET AL. TO THE DEBTORS'
DIP FINANCING MOTION AND CASH MANAGEMENT MOTION AND OBJECTION
TO THE DEBTORS' SUPPLEMENTAL MOTION FOR AUTHORITY TO (I) OBTAIN
JUNIOR POSTPETITION FINANCING, AND (II) SCHEDULE FINAL HEARING**

¹ The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are as follows: Sears Holdings Corporation (0798); Kmart Holding Corporation (3116); Kmart Operations LLC (6546); Sears Operations LLC (4331); Sears, Roebuck and Co. (0680); ServiceLive Inc. (6774); SHC Licensed Business LLC (3718); A&E Factory Service, LLC (6695); A&E Home Delivery, LLC (0205); A&E Lawn & Garden, LLC (5028); A&E Signature Service, LLC (0204); FBA Holdings Inc. (6537); Innovel Solutions, Inc. (7180); Kmart Corporation (9500); MaxServ, Inc. (7626); Private Brands, Ltd. (4022); Sears Development Co. (6028); Sears Holdings Management Corporation (2148); Sears Home & Business Franchises, Inc. (6742); Sears Home Improvement Products, Inc. (8591); Sears Insurance Services, L.L.C. (7182); Sears Procurement Services, Inc. (2859); Sears Protection Company (1250); Sears Protection Company (PR) Inc.(4861); Sears Roebuck Acceptance Corp. (0535); Sears, Roebuck de Puerto Rico, Inc. (3626); SYW Relay LLC (1870); Wally Labs LLC (None); SHC Promotions LLC (9626); Big Beaver of Florida Development, LLC (None); California Builder Appliances, Inc. (6327); Florida Builder Appliances, Inc. (9133); KBL Holding Inc. (1295); KLC, Inc. (0839); Kmart of Michigan, Inc. (1696); Kmart of Washington LLC (8898); Kmart Stores of Illinois LLC (8897); Kmart Stores of Texas LLC (8915); MyGofer LLC (5531); Sears Brands Business Unit Corporation (4658); Sears Holdings Publishing Company, LLC. (5554); Sears Protection Company (Florida), L.L.C. (4239); SHC Desert Springs, LLC (None); SOE, Inc. (9616); StarWest, LLC (5379); STI Merchandising, Inc. (0188); Troy Coolidge No. 13, LLC (None); BlueLight.com, Inc. (7034); Sears Brands, L.L.C. (4664); Sears Buying Services, Inc. (6533); Kmart.com LLC (9022); and Sears Brands Management Corporation (5365). The location of the Debtors' corporate headquarters is 3333 Beverly Road, Hoffman Estates, Illinois 60179.

The Official Committee of Unsecured Creditors (the “Creditors’ Committee”) of Sears Holdings Corporation and its affiliated debtors and debtors in possession (collectively, the “Debtors”), by and through its undersigned proposed counsel, hereby submits this objection (the “Supplemental Objection”) to (i) the entry of a final order (the “Final DIP Order”) granting the Debtors’ Motion for Authority to (A) Obtain Postpetition Financing, (B) Use Cash Collateral, (C) Grant Certain Protections to Prepetition Secured Parties, and (D) Schedule Second Interim Hearing and Final Hearing [ECF. No. 7] (the “DIP Financing Motion”), (ii) the entry of a final order (the “Final Cash Management Order”) granting the Motion of the Debtors for Authority to (I) Continue Using Existing Cash Management System, Bank Accounts, and Business Forms, (II) Implement Ordinary Course Changes to Cash Management System, (III) Continue Intercompany Transactions, and (IV) Provide Administrative Expense Priority for Postpetition Intercompany Claims and Related Relief [ECF. No. 5] (the “Cash Management Motion”), and (iii) the entry of an interim order granting the Debtors’ Supplemental Motion for Authority to (I) Obtain Junior Postpetition Financing, and (II) Schedule Final Hearing [ECF. No. 872] (the “Junior DIP Motion”). In support of this Supplemental Objection, the Creditors’ Committee respectfully states as follows:

PRELIMINARY STATEMENT¹

1. The Creditors’ Committee does not dispute the Debtors’ need for postpetition financing. What the Creditors’ Committee opposes are the efforts by the Debtors and their current and proposed lenders to run roughshod over the law on the basis that there are no financing alternatives available to the Debtors other than those contemplated by the DIP ABL

¹ Capitalized terms not defined herein shall have the meanings ascribed to them in the *Omnibus Objection of the Official Committee of Unsecured Creditors of Sears Holdings Corporation, Et Al. to the Debtors’ DIP Financing Motion and Cash Management Motion* (the “Objection”), the GACP Term Sheet, or the *Debtors’ Omnibus Reply to Objections to Debtors’ Motion for Authority to (A) Obtain Postpetition Financing, (B) Use Cash Collateral, (C) Grant Certain Protections to Prepetition Secured Parties and (D) Grant Related Relief* [ECF No. 864] (the “Reply”), as applicable.

Facility and Junior DIP Facility. By the Debtors' reply to the Objection, the Debtors did address a number of the concerns raised by the Creditors' Committee in the Objection.² However, a number of the Creditors' Committee's primary objections remain including, without limitation, (i) the Debtors' request to impose on their estates and their unsecured creditors a 5:1 Roll Up of prepetition secured debt to maximum incremental financing under the DIP ABL Facility at Debtors that are not obligated on the Prepetition ABL Obligations (the "Non-Obligor Debtors") and (ii) the granting of adequate protection claims and liens to the Prepetition Credit Parties (including the Second Lien Lenders) at Non-Obligor Debtors and on previously unencumbered assets (the "Previously Unencumbered Assets"), which is contemplated by both the Final DIP Order and Junior DIP order (the "Interim Junior DIP Order" and, together with the Final DIP Order, the "DIP Orders").

2. The Debtors' only justifications for providing the unlawful Roll Up and extensions of adequate protection are that the DIP ABL Facility and Junior DIP Facility are the best financing options available and have no material impact on unsecured creditors. Reply ¶¶ 1, 10, 13. However, approval of lender protections that violate the Bankruptcy Code and applicable law cannot be sanctioned under the guise that such terms are the best available.

3. In addition, the Debtors purport to mitigate any harm to unsecured creditors by providing for marshalling (the "Reverse Marshalling") "so that the proceeds of Previously Unencumbered Collateral will be placed in a cash account and applied to DIP ABL Obligations *only in the event that substantially all of the Prepetition ABL Collateral has been liquidated and proves to be insufficient to satisfy the ABL Lenders.*" Reply ¶ 5 (emphasis added). The Debtors'

² The Creditors' Committee is engaged in ongoing discussions with the Debtors and the DIP ABL Lenders to resolve the Creditors' Committee's outstanding objections and believes that a resolution may be possible in advance of the hearing. The Creditors' Committee does not anticipate reaching resolution with the Junior DIP Lenders.

statement in this regard is materially misleading to the Court. Indeed, the Reverse Marshalling concept is nothing more than an agreement between the DIP ABL Agent and the Junior DIP Agent with respect to the sharing of proceeds of collateral. In fact, (i) the Final ABL DIP Order and Interim Junior DIP Order seek express waivers of the doctrine of marshalling for the benefit of the DIP ABL Lenders and Junior DIP Lenders and (ii) the proposed DIP Intercreditor Agreement expressly provides that (x) the Reverse Marshalling is solely for the benefit of the Senior DIP Agents (as defined in the DIP Intercreditor Agreement) and the Junior DIP Agent, (y) the Reverse Marshalling waterfall can be amended at any time with the consent of the Senior DIP Agents and the Junior DIP Agent and (z) the Debtors and their estates are not third party beneficiaries of the Reverse Marshalling. Accordingly, the DIP ABL Facility cannot be approved unless the inappropriately broad grant of claims and liens against the Debtors in connection with the Roll Up and adequate protection is eliminated and the Reverse Marshalling provisions are incorporated into the DIP Orders, cannot be amended without Court order and provide express enforcement rights in favor of the Debtors and their estates.

4. By the Junior DIP Motion, the Debtors seek approval of the Junior DIP Facility. Based on the Creditors' Committee's review of the GACP Term Sheet and proposed Interim Junior DIP Order, many of the Creditors' Committee's continuing objections to the DIP ABL Facility are applicable equally to the Junior DIP Facility, including the proposed grants of adequate protection for the benefit of the Prepetition Creditor Parties (including the Second Lien Lenders) at Non-Obligor Debtors and on Previously Unencumbered Assets. In addition, the Junior DIP Facility matures prior to the DIP ABL Facility, thereby shortening the term of the DIP ABL Facility (and effectively increasing the cost thereof). Alternatively, the Junior DIP Facility permits the Debtors to extend the Junior DIP Maturity Date to be coterminous with the DIP ABL Facility so long as

the Debtors pay the Junior DIP Lenders an additional fee of approximately \$4.4 million. The Junior DIP Maturity Date should be modified to be consistent with the DIP ABL Maturity Date without the incurrence of a significant incremental extension fee. Without these modifications, and as discussed in more detail below, the Debtors have failed to demonstrate that the Junior DIP Facility is fair, reasonable and adequate in accordance with applicable law.

SUPPLEMENTAL BACKGROUND

A. The Proposed Junior DIP Facility

5. On November 14, 2018, the Debtors filed a *Notice of Filing of Term Sheet Regarding Junior Secured Debtor-in-Possession Multiple Draw Term Loan Facility* [ECF. No. 735] which provided a revised Junior DIP term sheet (the “GACP Term Sheet”) for a junior secured debtor-in-possession multiple draw term loan facility (the “Junior DIP Facility”) to be provided by GACP Finance Co., LLC, as agent for the Junior DIP Lenders (in such capacity, the “Junior DIP Agent”).

6. The obligations under the Junior DIP Facility are to be: (i) joint and several superpriority administrative expense claims against every Debtor (the “Junior DIP Facility Superpriority Claims”), which will be of equal priority to the DIP ABL Superpriority Claims; (ii) secured by liens on all unencumbered assets, and all proceeds thereof (other than the Specified Collateral), including liens on Avoidance Action Proceeds (collectively, the “Unencumbered Assets”), which liens will be junior only to the DIP ABL Liens; (iii) secured by a first priority lien on all of the rights, title and interests of any Obligor in the Specified Collateral,³ which security

³ Specified Collateral means (i) all of the rights, title, and interests of any Obligor in the Specified Store Assets (specifically store numbers 7777, 7749 and 9423), and (ii) all of the rights, title, and interests of any Obligor in that certain Specified Litigation Claim (specifically anti-trust claims or other claims against any of Visa Inc., Mastercard Inc., JPMorgan Chase & Co, Citigroup N.A., Bank of America N.A., or any of their respective affiliates in relation to certain practices with respect to merchant processing fees and merchant processing agreements, and the proceeds thereof, and any settlement with respect to the foregoing.

interests and liens shall be *pari passu* with the DIP ABL Liens without giving regard to the Roll Up portion thereof; (iv) secured by liens on all assets, and all proceeds thereof that are subject to valid and perfected liens existing on the Petition Date securing indebtedness and other obligations other than the Prepetition First Lien Indebtedness, the Pre-Petition L/C Indebtedness or the Pre-Petition Second Lien Indebtedness, junior only to such other Prepetition Liens and the DIP ABL Liens; and (v) secured by liens on the Prepetition ABL Collateral and all proceeds thereof, which liens will be junior only to (a) the Permitted Prior Liens, (b) the DIP ABL Liens, (c) the Prepetition Revolving Facilities and Prepetition 2016 Term Loan Facility Adequate Protection Liens, (d) the Prepetition 2018 FILO Facility Adequate Protection Liens, (e) the Prepetition LC Facility Agreement Adequate Protection Liens, (f) the Prepetition Facilities Prepetition Liens and Prepetition LC Facility Agreement Prepetition Liens, (g) the Prepetition Second Lien Facilities Adequate Protection Liens, and (h) the Prepetition Second Lien Facilities Pre-Petition Liens (all such liens discussed in this paragraph 6, collectively, the “Junior DIP Facility Liens” and the property subject to such Junior DIP Facility Liens, the “Junior DIP Facility Collateral”).

7. The adequate protection provided under the Junior DIP Facility is substantially the same as provided in connection with the DIP ABL Facility. GACP Term Sheet at p. 6.

8. On November 23, 2018, the Debtors filed the Reply which resolved certain of the Creditors’ Committee’s Objections.

9. On November 25, 2018, the Debtors filed the Junior DIP Motion, including a revised GACP Term Sheet.

SUPPLEMENTAL OBJECTION

A. There is No Basis in the Law for Granting Claims and Liens on Assets at Prepetition Non-Obligor Debtors

10. By the Debtors' logic, because the Prepetition ABL Lenders want claims and liens on assets at Non-Obligor Debtors, they should get them because, without the DIP ABL Facility, the Debtors will be forced to liquidate. Reply ¶ 1. This reasoning is flawed for a number of reasons. First, the Debtors have failed to provide any legal support for the grant of claims and liens against Non-Obligor Debtors. Second, the Prepetition ABL Lenders are oversecured by a substantial equity cushion in the Prepetition ABL Collateral. Third, the intercompany claims language proposed by the Creditors' Committee in the Objection protects the Prepetition ABL Lenders against use of their collateral in intercompany transactions without the need for grants of claims and liens against Non-Obligor Debtors. Lastly, the Prepetition ABL Lenders want the additional grant of claims and liens in Non-Obligor Debtors simply because they want it—the Prepetition ABL Lenders cannot articulate why they want such additional protections because they do not have any information about what additional value they would be getting from the grant of such claims and liens.

11. In support of the Roll Up, the Debtors state that there is “ample evidence” in this district that supports approving postpetition financing on similar terms—terms that provide claims against, and liens on assets of, debtors that were not prepetition obligors on the prepetition debt facilities. Reply ¶¶ 8. The Debtors further state that the Roll Up complies with applicable law. *Id.* ¶¶ 9-11. Remarkably, notwithstanding such “ample evidence”, the Debtors cite to only two cases, *In re Rockport Co., LLC*, Case No. 18-11145 (LSS) (Bankr. D. Del. June 29, 2018) and *In re The Standard Register Co.*, Case No. 15-10541 (BLS) (Bankr. D. Del. Apr. 16, 2015) (ECF No. 290), *Id.* ¶ 11, as examples of final postpetition financing orders approving the grant of

interests in non-obligor debtors, neither of which is binding on this Court nor relevant to the present facts and circumstances. Moreover, based on a read of the pleadings filed and the relevant hearing transcripts in *Rockport* and *Standard Register* (copies of such transcripts are attached hereto as Exhibit A), it does not appear that the issue regarding the grant of claims against, and liens on assets of, non-obligor debtors was addressed by the Court. The law simply does not support the grant of such claims and liens against Non-Obligor Debtors in connection with a roll up or adequate protection. Thus, the Debtors have failed to demonstrate that the grant of such claims and liens against Non-Obligor Debtors is fair and reasonable

12. Significantly, the Court's denial of claims and liens against Non-Obligor Debtors in connection with the Roll Up and adequate protection will not impair the Prepetition ABL Lenders' protections because by the Debtors' own admission the Prepetition ABL Obligations were oversecured on the Petition Date by an equity cushion in their collateral of over \$1 billion. *Id.* ¶¶ 5, 14 ("Prepetition ABL Collateral was valued at approximately \$2.8 billion (of which the net orderly liquidation value ("NOLV") of the Debtors' inventory was valued at about \$2.74 billion) with approximately \$1.53 billion borrowed against it under the Prepetition ABL Facility.") (citing Supplemental Riecker Declaration). There simply is no basis for approving the 5:1 Roll Up and the grant of the claims and liens on account of adequate protection against Non-Obligor Debtors where the Prepetition ABL Lenders are oversecured substantially by the Prepetition ABL Collateral. The Prepetition ABL Lenders' desire for the Roll Up and the inappropriate grants of claims and liens against Non-Obligor Debtors in connection therewith and as adequate protection is not a sufficient basis for such relief where the law does not allow for such protections even if such postpetition financing were the only financing available to the Debtors.

13. Further, the intercompany transfer language proposed by the Creditors' Committee's Proposed Final Order attached to the Objection serves to protect the Prepetition ABL Lenders without the need to grant claims and liens against Non-Obligor Debtors. Specifically, the Creditors' Committee's proposed language provides that, in connection with a postpetition intercompany transaction, the transferring Debtor would have a superpriority claim (the "Postpetition Superpriority Claim") and lien (the "Postpetition Intercompany Lien") against the beneficiary Debtor (the "Beneficiary Debtor") in an amount equal to the amount by which the fair value of the property or benefit transferred exceeds the aggregate fair value of the property or benefit received. Such Postpetition Superpriority Claims would be senior to all other superpriority claims, subject and subordinate only to the Carve-Out and the DIP Superpriority Claims, and the Postpetition Intercompany Liens would be senior to all other liens on the applicable Beneficiary Debtor's property other than the Carve-Out and DIP ABL Liens.

14. This construct protects all parties involved without granting the Roll Up or adequate protection claims and liens against Non-Obligor Debtors. For example, if Kmart Holding Corporation ("Kmart"), which is an obligor on the Prepetition ABL Obligations, transfers \$1 million of Prepetition ABL Collateral to Sears Buying Services, Inc. ("Sears Buying Services"), a Non-Obligor Debtor, Kmart would have a Postpetition Superpriority Claim and a Postpetition Intercompany Lien against Sears Buying Services. Kmart's Postpetition Superpriority Claim and Postpetition Intercompany Lien against Sears Buying Services would be subordinate only to the Carve-Out, DIP ABL Lenders' Superpriority Claims and the DIP ABL Liens. Kmart's Postpetition Superpriority Claim and Postpetition Intercompany Lien against Sears Buying Services would ensure that Kmart receives back the value of the \$1 million transferred to Sears Buying Services and the proceeds of Kmart's Postpetition Superpriority Claim and Postpetition

Intercompany Lien would be collateral for the Prepetition ABL Lenders ensuring they are not adversely impacted by the postpetition intercompany transfer.

15. Finally, the Prepetition ABL Lenders are unable to articulate the benefit the grant of claims and liens against Non-Obligor Debtors provides them, particularly where they are oversecured by the Prepetition ABL Collateral. The Creditors' Committee is working with the Debtors on a Statement of Stipulated Facts in connection with the hearing on the DIP Financing Motion that, on information and belief, the Creditors' Committee expects to reflect the following: Historical, current and estimated future operating cash flows on a Debtor-entity by Debtor-entity basis do not exist. In addition, a comprehensive schedule or other statement regarding the identity of which Debtor entity owns the Previously Unencumbered Assets that would become encumbered by the DIP ABL Facility do not exist. Moreover, there does not exist any information regarding the estimated cash each Debtor will receive from the DIP ABL Facility, or a budget for the uses of funds each Debtor entity will receive from the proposed DIP ABL Facility. Without this fundamental information, the Prepetition ABL Lenders cannot explain why they require claims and liens against Non-Obligor Debtors to which they are not legally entitled. They just want it. Neither the Bankruptcy Code nor applicable law supports the grant of claims and liens against Non-Obligor Debtors merely to satisfy a lender's desire for more protection. Accordingly, the DIP ABL Facility should be modified to eliminate the grant of claims and liens in favor of the Prepetition ABL Lenders and other Prepetition Credit Parties against Non-Obligor Debtors either under the Roll Up or as adequate protection.

B. Additional Objections to the DIP ABL Facility

16. In connection with the Reply, the Debtors included a proposed Final DIP Order that contains provisions that were not included in the Interim DIP ABL Order. Based on the

Creditors' Committee's review thereof, the Creditors' Committee has the following additional objections and remaining objections in addition to those addressed herein and as listed in Section B of the Committee Objection Issues Chart attached to the Reply as Annex A ("Annex A"):

- Winddown Account (Final DIP Order ¶ 23): Based on the Creditors' Committee's diligence to date, the cost of the Debtors' winddown of their operations will exceed the proposed Winddown Account budget of \$200 million. As such, the Creditors' Committee submits that the proceeds of the sale of the medium term notes recently approved by this Court, which notes and proceeds were not Prepetition ABL Collateral or part of the asset base considered by the DIP ABL Lenders, should be added to the Winddown Account;
- Definition of ESL (Final DIP Order ¶ H(g)): The Creditors' Committee submits that the definition of ESL should be expanded, as set forth in the Objection, to include affiliates of the ESL Affiliates;
- Definition of Acceptable Plan of Reorganization (Annex A at p. 4): The modified definition of Acceptable Plan of Reorganization continues to require releases for the Prepetition Credit Parties, which includes ESL. The definition of Acceptable Plan of Reorganization should be modified further to eliminate any requirement that ESL, as a Prepetition Credit Party or otherwise, is provided a release;
- 506(c) waivers and 552 provisions (Final DIP Order ¶¶ O(j), 44): These provisions should be revised to make clear that the 506(c) waivers and benefits of 552 apply only to the Prepetition ABL Obligations (i.e., the DIP ABL Facility, the Prepetition ABL Obligations, the Prepetition ABL 2018 FILO Facility and the Stand-Alone L/C Facility) but do not extend to benefit ESL;
- Syndication of DIP ABL Facility (Final DIP Order ¶ 6): The proposed Final DIP Order added a new paragraph regarding the syndication of the DIP ABL Facility. In light of the fact that the Final DIP Order permits the DIP ABL Lenders to credit bid their allowed claims under section 363(k) of the Bankruptcy Code and the Creditors' Committee is continuing to investigate claims and causes of action against ESL, there should be a prohibition in the Final DIP Order with respect to ESL participating in the DIP ABL Facility, whether directly, indirectly, through participations or otherwise;
- Carve-Out (Final DIP Order ¶ 21): The Final DIP Order should be (i) modified to increase the amount of the Carve-Out to include the out of pocket expenses incurred by Creditors' Committee members in connection with their service on the Creditors' Committee and (ii) clarified to provide that the Permitted Carve-Out Consummation Fees will include any consummation or deferred fee that will be payable to Houlihan Lokey Inc. ("Houlihan"), the Creditors' Committee's proposed investment banker, subject to this Court's approval of the Creditors'

Committee's forthcoming application to retain Houlihan. The Creditors' Committee expects Houlihan's proposed deferred fee to be \$7.5 million less crediting of monthly fees after six months;

- Budget and Borrowing Base Reporting; Budget Compliance (Final DIP Order ¶ 22): The DIP ABL Facility should be modified (x) to eliminate the Permitted Variance Test and, instead, provide for a gross disbursements test or a flat net variance permitted amount of over \$50 million instead of the current Permitted Variance Test and (y) to exclude professional fees. The Permitted Variance Test is on a rolling basis with a static budget where timing differences can cause the Debtors to trip this covenant easily.⁴ Favorable variances should be allowed to be carried over from prior four-week periods;
- Selection of Liquidation Agent (DIP ABL Credit Agreement section 6.01(s)): The DIP ABL Credit Agreement should be modified to limit the DIP ABL Lenders' control in their sole and absolute discretion over the appointment of a liquidation consultant and liquidation agent; and
- Prepetition Consolidated Loan Lenders (Final DIP Order ¶ 60): The proposed Final DIP Order added a new paragraph granting adequate protection, including the payment of postpetition interest, to the Prepetition Consolidated Loan Lenders. This provision should not be approved in connection with the proposed Final DIP Order but rather should be proposed on appropriate notice to ensure that parties in interest are given sufficient opportunity to analyze whether the Prepetition Consolidated Loan Lenders are entitled to such adequate protection and be heard on such issues.

C. The Proposed Reverse Marshalling Concept is Misleading and Fails to Mitigate Harm to Unsecured Creditors

17. The Debtors purport to mitigate the harm to unsecured creditors resulting from the grant of claims and liens against Non-Obligor Debtors by implementing the Reverse Marshalling concept whereby the DIP ABL Lenders "have agreed to look first to the proceeds of the Prepetition ABL Collateral to repay the obligations under the DIP ABL Facility." Reply ¶ 19. The Reply specifies that the DIP ABL Lenders "will seek repayment from the proceeds of the previously unencumbered collateral only to the extent that the proceeds of the Prepetition ABL

⁴ For example, if there is a favorable timing variance in week 1 of \$50 million and this variance reverses in week 2 (i.e., an unfavorable variance of \$50 million), then in week 5, one would need a favorable variance of \$50 million to stay compliant (i.e., the \$50 million favorable variance in week 1 is gone, but the \$50 million unfavorable variance in week 2 is still there). These types of variances are not unusual.

Collateral will be insufficient to repay the entire DIP ABL Facility outstanding at the time when it has to be repaid.” *Id.* This, however, is misleading and does not provide the Court with any ability to ensure that the proceeds of Previously Unencumbered Assets only will be used to repay the DIP ABL Facility in the event the proceeds of the Prepetition ABL Collateral are insufficient as the proposed Final DIP Order does not require that the DIP ABL Lenders first seek repayment from the proceeds of Prepetition ABL Collateral.⁵

18. Instead, the proposed Final DIP Order merely references the DIP Intercreditor Agreement which is an agreement solely between the DIP ABL Agents and the Junior DIP Agent, which may be amended at any time by such parties without seeking Court approval. Proposed Final DIP Order ¶ 34(e). Significantly, the Debtors are not party to the DIP Intercreditor Agreement, and section 7.10 of the DIP Intercreditor Agreement provides for no third party beneficiaries, which should include the Debtors and the Debtors’ unsecured creditors. Moreover, the DIP Intercreditor Agreement provides that the proceeds of Previously Unencumbered Assets may be used to repay the DIP ABL Facility only after all but a “de minimus” amount of Prepetition ABL Collateral of the type that is eligible for the Borrowing Base has been liquidated, but what constitutes a “de minimus” amount is not defined. In addition, the requirement that proceeds of Previously Unencumbered Assets may be used to repay the DIP ABL Facility only after all but a “de minimus” amount of Prepetition ABL Collateral that is eligible for the Borrowing Base has been liquidated is too limited. The proceeds of Previously Unencumbered Assets should be permitted to be used to repay the DIP ABL Facility only after all Prepetition ABL Collateral is liquidated or, at a minimum, only after all but a “de minimus” amount of all Prepetition ABL Collateral has been liquidated. Thus, in

⁵ The Reverse Marshalling is also inherently inconsistent with the Debtors’, the DIP ABL Lenders’ and the Junior DIP Lenders’ request for a waiver of the doctrine of marshalling.

light of the DIP ABL Agent's and the Junior DIP Agent's unfettered ability to modify the DIP Intercreditor Agreement, and the DIP Intercreditor Agreement's failure to define what is considered a "de minimus amount" of Prepetition ABL Collateral, the harm to unsecured creditors has not been mitigated. Accordingly, to the extent the concept of Reverse Marshalling was intended to provide the Creditors' Committee and the Court with comfort that the proceeds of Previously Unencumbered Assets will be preserved for the benefit of unsecured creditors and the DIP ABL Lenders will seek repayment from such Previously Unencumbered Assets only in the event the proceeds of the Prepetition ABL Collateral are insufficient to pay the entire DIP ABL Facility, the proposed Final DIP Order must be modified to provide expressly for such protections and modify the marshalling waiver to be consistent therewith.

D. The Proposed Adequate Protection, Case Milestones and Events of Default in the Junior DIP Facility Raise Duplicative Objections to those Raised in Connection with the DIP ABL Facility

19. As with the DIP ABL Facility, the terms of the Junior DIP Facility violate applicable law in several respects. First, the proposed adequate protection for the Prepetition Credit Parties provided under the Junior DIP Facility is overbroad and inappropriately provides such lenders with adequate protection claims at, and liens on the assets of, all of the Debtors, including Unencumbered Assets and Avoidance Action Proceeds. GACP Term Sheet at pp. 6-8; Objection ¶ D.

20. Liens on Avoidance Action Proceeds should be preserved for the benefit of unsecured creditors and should not be pledged either as collateral for the Junior DIP Facility or as adequate protection for the Prepetition Credit Parties. *See* Objection ¶¶ 46-48. In addition, the covenants, events of default and Case Milestones provided in the Junior DIP Facility—all of which are substantially similar to those provided in the DIP ABL Facility—will hinder the Debtors'

reorganization by (i) providing the Junior DIP Lenders with undue control and (ii) dictating the course of these chapter 11 cases in contravention of the Debtors' fiduciary duties to maximize value for all creditors. GACP Term Sheet at pp. 9-15; Objection ¶ G. Accordingly, these inappropriate provisions should be stricken or modified from both the DIP ABL Facility and the Junior DIP Facility.

21. Finally, the Junior DIP Facility also provides for a Permitted Variance Test that, similar to the Permitted Variance Test in the DIP ABL Facility could be tripped easily. As with the DIP ABL Facility, the Junior DIP Facility should be modified to provide for a gross disbursements test or a flat net variance permitted amount of over \$50 million instead of the current Permitted Variance Test and to exclude professional fees.⁶

E. The Junior DIP Facility Maturity Date Should Be Extended and the Extension Fee Should Be Stricken

22. In addition to the objections raised in connection with the DIP ABL Facility which are equally applicable to the Junior DIP Facility, the Junior DIP Facility improperly shortens the maturity of the DIP ABL Facility and contains a hidden fee that increases the cost of the Junior DIP Facility by approximately \$4.4 million. The Junior DIP Facility provides a maturity date that is the *earliest* of (i) eight months after the Petition Date (the "Junior DIP Maturity Date"), (ii) twelve months if the Debtors exercise the option to extend the maturity by four months (the "Extension Option"), and (iii) the maturity date under the DIP ABL Facility (which is the earliest of, among other things, (x) twelve months after the Petition Date, (y) the Junior DIP Maturity Date, and (z) the sale of substantially all of the Prepetition ABL Collateral) (the "DIP ABL Maturity

⁶ The proposed Final DIP Order modifies the Permitted Variance Test to make it more difficult for the Debtors to satisfy this covenant. Specifically, the revised Permitted Variance Test is on a rolling basis with a static budget where timing differences can cause the Debtors to trip this covenant easily. Thus, as further discussed in the Objection, the Permitted Variance Test should be modified to provide for a gross disbursements test or a flat net variance permitted amount of over \$50 million, and this calculation should exclude professional fees.

Date”). The Junior DIP Maturity Date should be modified to be coterminous with the DIP ABL Maturity Date. In its current form, the Junior DIP Maturity Date is four months earlier than the DIP ABL Maturity Date. GACP Term Sheet at p. 2. Thus, in the event the Debtors do not exercise the Extension Option, the DIP ABL Maturity Date by its terms will be reduced to eight months from the Petition Date, even though the Debtors paid fees for a one-year DIP ABL Facility (and effectively increasing the cost thereof). The Debtors should not be forced to reduce the DIP ABL Maturity Date based on a costly extension of the Junior DIP Facility.

23. Moreover, in the event the Debtors exercise the Extension Option to align the Junior DIP Maturity Date with the DIP ABL Maturity Date, under the Junior DIP Facility, the Debtors are required to pay an extension fee of 1.25% (the “Extension Fee”). The Extension Fee is, in effect, a hidden fee which increases the cost of the Junior DIP Facility from 3.0% to 4.25%— an increase of approximately \$4.4 million. Thus, the overall cost of the Junior DIP Facility is significantly greater than it appears because the near term Junior DIP Maturity Date effectively requires the Debtors either to pay an overly expensive Extension Fee or shorten the term of the DIP ABL Facility by four months. In light of the significant challenges in these cases, the Debtors should not be hamstrung by the Junior DIP Maturity Date’s threat of shortening the DIP ABL Maturity Date or paying an additional approximate \$4.4 million. Accordingly, the Junior DIP Maturity Date should be modified to be coterminous with the DIP ABL Maturity Date, and the Extension Fee should be stricken.

RESERVATION OF RIGHTS

24. The Creditors’ Committee reserves its rights to raise additional objections to the Junior DIP Facility and the DIP ABL Facility and any and all other documents arising from or relating to the DIP Financing Motion up until and during the Final Hearing on the DIP ABL Facility and the interim hearing on the Junior DIP Facility.

CONCLUSION

WHEREFORE, the Creditors' Committee respectfully requests that the Court (i) deny the entry of final orders approving the DIP Financing Motion and the Cash Management Motion without requiring the material modifications set forth in the Objection and herein that have not been addressed by the Debtors' proposed Final DIP Order, (ii) deny the entry of an interim order approving the Junior DIP Motion without requiring the material modifications set forth herein, and (ii) grant the Creditors' Committee such other and further relief as is just, proper and equitable.

New York, New York
Dated: November 26, 2018

AKIN GUMP STRAUSS HAUER & FELD LLP

By: /s/ Ira S. Dizengoff

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EXHIBIT A

UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

IN RE: Chapter 11
Case No. 18-11145 (LSS)
THE ROCKPORT COMPANY, LLC,
Courtroom No. 2
824 N. Market St
Wilmington, Delaware 19801
Debtors. June 13, 2018
11:00 A.M.

TRANSCRIPT OF HEARING
BEFORE HONORABLE LAURIE SELBER SILVERSTEIN
UNITED STATES BANKRUPTCY JUDGE

APPEARANCES:

For the Debtors: Mark Collins, Esquire
Brendan Schlauch, Esquire
Michael Merchant, Esquire
Cory Kandestin, Esquire
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INDEX

PAGE

Motion of Debtors for Entry of Interim and Final Orders Authorizing (I) the Debtors to Pay (A) Certain Prepetition Claims of Shippers and Warehousemen and (B) Import Charges and (II) Financial Institutions to Honor and Process Related Checks and Transfers [Docket No. 8 - filed May 14, 2018].

Motion of Debtors for Entry of an Order (I) Authorizing the Debtors to (A) Conduct Store Closing Sales at Their North American Retail Locations and (B) Pay Store Closing Bonuses to Employees at the Closing Stores and (II) Granting Related Relief [Docket No. 47 - filed May 15, 2018].

Motion for Entry of an Order Authorizing the Official Committee of Unsecured Creditors to File Under Seal Its Objection of the Official Committee of Unsecured Creditors to Motion of Debtors for Entry of Interim and Final Orders (I) Authorizing the Debtors to (A) Obtain Postpetition Financing on a Super-Priority, Senior Secured Basis and (B) Use Cash Collateral, (II) Granting (A) Liens and Super-Priority Claims and (B) Adequate Protection to Certain Prepetition Lenders, (III) Modifying the Automatic Stay, (IV) Scheduling a Final Hearing, and (V) Granting Related Relief [Docket No. 169 - filed June 8, 2018].

RULING: 50

Motion of Debtors for Entry of Interim and Final Orders (I) Authorizing the Debtors to (A) Obtain Postpetition Financing on a Super-Priority, Senior Secured Basis and (B) Use Cash Collateral, (II) Granting (A) Liens and Super-Priority Claims and (B) Adequate Protection to Certain Prepetition Lenders, (III) Modifying the Automatic Stay, (IV) Scheduling a Final Hearing, and (V) Granting Related Relief [Docket No. 15 - filed May 14, 2018].

Application of the Debtors for the Entry of an Order Pursuant to Sections 327(a) and 328(a) of the Bankruptcy Code (A) Authorizing the Employment and Retention of Houlihan Lokey Capital, Inc. as Financial Advisor and Investment Banker to the Debtors, Nunc Pro Tunc to the Petition Date, (B) Waiving Certain Time-Keeping Requirements Pursuant to Local Rule 2016-2(h) and (C) Granting Related Relief [Docket No. 105 - filed May 23, 2018].

1 RULING: 48

2 Motion of Debtors for Entry of an Order Approving Key Employee
3 Incentive Plan [Docket No. 107 - filed May 23, 2018].

4 DEBTORS' WITNESS(s)

5 **PAUL KOSTUROS**

6 Direct examination by Mr. Kandestin 85

7 Cross-examination by Ms. Pillon 103

8 Redirect Examination by Mr. Kandestin 113

9

10 **NATHAN COURT**

11 Direct Examination by Mr. Kandestin 116

12

13 EXHIBITS: ID REC'D

14 D1 Prepetition ABL Facility Agreements

15 D2 Borrowing Base Certificates

16 D3 Summary of Allocation Method

17 Richter Advisory Group Objection

18 Declaration of Kosturos

19

20

21

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1 (Proceedings commence at 11:06 a.m.)

2 THE COURT: Please be seated.

3 MR. COLLINS: Good morning, Your Honor.

4 THE COURT: Good morning.

5 MR. COLLINS: For the record, Mark Collins of
6 Richards, Layton & Finger, on behalf of the Rockport group of
7 debtors.

8 Your Honor, we have a full agenda today, although
9 I think we have made substantial progress in resolving
10 various of the substantive contested matters on today's
11 agenda. Your Honor, what I'd like to do is briefly walk
12 through what we're going to do today, what is resolved, and
13 how we might move the agenda around a little bit, to make it
14 more efficient.

15 THE COURT: Okay.

16 MR. COLLINS: Your Honor, I would first start with
17 Agenda Item Number 1, which is our motion to withdraw our --
18 we have withdrawn our motion to file the fee letter under
19 seal. We have agreed, in lieu of that, to simply put on the
20 record the ABL fees, which is a commitment fee of \$150,000
21 and a DIP agent fee of \$300,000, for a total of \$450,000.
22 And with that --

23 THE COURT: For the ABL.

24 MR. COLLINS: Correct, just for the ABL. The
25 noteholder DIP facility, the fees were disclosed in the

1 motion itself. So, with that, I think that resolves the
2 issue. And we appreciate working with the U.S. Trustee on
3 resolving that.

4 Your Honor, what we then do is turn first, very
5 briefly, to Agenda Item Number 14. This is the retention
6 application for HYPERAMS. We do have a -- I believe, a
7 corrected order that we would like to submit on that; an
8 error on our side, so we apologize for that.

9 We would then turn to Agenda Item 15. We would
10 then go to Agenda Item 18, which is the A&M retention
11 application. And then we would go to Mr. Merchant, who will
12 be presenting the store closing motion, which is at Agenda
13 Item Number 17.

14 (Participants confer)

15 MR. COLLINS: And Agenda Item Number 22, which is
16 the key employee incentive plan. Both the store closing
17 motion and the key employee incentive plan motion are
18 uncontested.

19 Following that, Your Honor, we would turn to the
20 DIP, our final DIP hearing. We're pleased to report that we
21 have resolved, entirely, the unsecured creditors' committee
22 objection to the final DIP, to both the noteholder DIP and
23 the ABL DIP. We do have the remaining issue with the
24 information officer, with respect to the allocation of the
25 ABL debt --

1 THE COURT: Yes.

2 MR. COLLINS: -- amongst the debtor entities.

3 Finally, Your Honor, we would turn to the Houlihan
4 retention application because the settlement in the DIP --
5 with respect to the DIP motion resolves the committee's
6 objection to the Houlihan retention application.

7 THE COURT: Okay.

8 MR. COLLINS: So we'll take that last.

9 So with that, I guess I'll turn it first over to
10 Mr. Merchant for a presentation on the HYPERAMS corrective
11 order.

12 THE COURT: Okay.

13 MR. COLLINS: Thank you, Your Honor.

14 MR. MERCHANT: Good morning, Your Honor.

15 THE COURT: Good morning.

16 MR. MERCHANT: Michael Merchant of Richards,
17 Layton & Finger, on behalf of the debtors.

18 Your Honor, our apologies for this. There were a
19 lot of certificates filed, trying to clear up things for this
20 hearing. And with regards to Agenda Item Number 14, it's the
21 retention application of HYPERAMS, LLC. They are our
22 consultant in -- with respect to the store closing sales --

23 THE COURT: Uh-huh.

24 MR. MERCHANT: -- that Your Honor will hear a
25 little bit about later.

1 The certificate that was filed actually attached a
2 correct black-line, but the clean was a prior version, and it
3 did not reflect the agreed changes that we had negotiated
4 with the --

5 THE COURT: Okay.

6 MR. MERCHANT: -- Office of the United States
7 Trustee. So I have a corrected clean version, if I may
8 approach.

9 THE COURT: Yes.

10 MR. MERCHANT: And to the extent Your Honor would
11 like to walk through the differences in the order that we
12 agreed to, I'm happy to do that, as well.

13 THE COURT: I read the black-line.

14 MR. MERCHANT: Okay.

15 THE COURT: I just signed the clean, assuming it
16 was correct.

17 (Laughter)

18 MR. MERCHANT: Perfect. Thank you, Your Honor.

19 THE COURT: Okay.

20 (Pause in proceedings)

21 THE COURT: Okay. That corrected order is signed.

22 MR. MERCHANT: Thank you, Your Honor.

23 I'm going to cede the podium to Brendan Schlauch
24 to handle Agenda Item 15.

25 MR. SCHLAUCH: Good morning, Your Honor. For the

1 record --

2 THE COURT: Good morning.

3 MR. SCHLAUCH: -- Brendan Schlauch, Richards,
4 Layton & Finger, on behalf of the debtors.

5 The next item this morning is the final shippers
6 and warehousemen order, which is Agenda Number 15 on the
7 agenda. I have a clean and black-line version of the final
8 order, if I may approach.

9 THE COURT: Yes.

10 (Participants confer)

11 MR. SCHLAUCH: So, pursuant to this motion, the
12 debtors seek to pay pre-petition claims of shippers and
13 warehousemen, as well as pre-petition import duties, tariffs,
14 and other charges. The debtors did not receive any comments
15 or responses to this order; however, the debtors did file a
16 supplement to the motion. And so we thought it was best to
17 just give the Court an opportunity to review the supplement
18 and be available if you had any questions.

19 The supplement to the motion was really to alert
20 the Court and other parties-in-interest of certain changes
21 that would be made to the final order, related to the import
22 and custom charges.

23 As explained in the supplement, the debtors
24 inadvertently exceeded the three-hundred-thousand-dollar
25 import charges cap set forth in the interim order. This

1 occurred when the U.S. Customs Department swept the debtors'
2 operating account for import charges equal to approximately
3 \$435,000. Although the debtors do not dispute the amount of
4 the charges, the sweep did occur without the debtors' consent
5 and without notice to the debtors.

6 Typically, U.S. Customs would provide the debtors
7 with two days' notice, and the debtors would deposit the
8 funds into the operating account, and then Customs would
9 sweep it. If we had advanced notice, we would have, ideally,
10 altered the Court and filed a motion to increase the cap;
11 however, Customs swept it, swept our accounts. So the
12 revised order adds clarifying language, authorizing that
13 specific import charges payment.

14 Also, as explained in the supplement, the final
15 order was modified to seek authority to pay other U.S.
16 Customs import charges, which are related to the debtors'
17 reconciliation program. These reconciliation payments are on
18 account of import charges incurred in 2017, so pre-petition
19 charges, and are consisted with the debtors' ordinary course
20 business practice.

21 We understand that, because the weights of the
22 goods shipped are hard to estimate ahead of time, the debtors
23 opt to sort of estimate their payments, to maintain a
24 consistency throughout the year. The debtors then reconcile
25 what they actually paid, versus what they should have paid to

1 Customs, and pay it around this time every year. We
2 understand that the debtors are in the process of finalizing
3 those reconciliations, and estimate that the reconciliation
4 amount should be about \$270,000.

5 The debtors believe the final order, as modified,
6 is critical to ensuring the uninterrupted flow of merchandise
7 that the debtors rely on in the ordinary course of their
8 business. Without the relief in the final order, debtors'
9 supply chain may be disrupted, and such disruption,
10 particularly a disruption caused by the import charges or
11 nonpayment of the import charges could result in additional
12 expense and detriment to the debtors' estates.

13 Accordingly, unless Your Honor has any questions
14 or concerns, we respectfully request that the Court enter a
15 final order.

16 THE COURT: Okay. It wasn't clear to me from the
17 supplement, but I think I'm understanding from your
18 presentation that this additional \$435,000 that was swept
19 from the account was on account of proper charges --

20 MR. SCHLAUCH: Correct.

21 THE COURT: -- but just lack of notification.

22 MR. SCHLAUCH: Correct. There's an --

23 THE COURT: Okay.

24 MR. SCHLAUCH: -- agreement between the parties
25 that would have provided for two days' notice.

1 THE COURT: Okay. Does anyone wish to be heard
2 with respect to the supplemental request or the final order?

3 (No verbal response)

4 THE COURT: Okay. I hear no one.

5 I will approve it, the final order, as modified by
6 the supplemental request, again, finding that it's necessary
7 for these payments to be made, in order to obtain the goods
8 that are being shipped into the States, so I will sign it.

9 MR. SCHLAUCH: Thank you, Your Honor.

10 I will now turn the podium over to Mrs. Steele --
11 or Ms. Steele.

12 (Participants confer)

13 MS. STEELE: Good morning, Your Honor.

14 THE COURT: Good morning.

15 MS. STEELE: Amanda Steele, Richards, Layton &
16 Finger, on behalf of the debtors.

17 Your Honor, I'm here to present Agenda Item Number
18 18, which is the debtors' motion to retain Alvarez & Marsal
19 as Interim Chief Financial Officer, Interim Chief Operating
20 Officer, and for additional personnel. It would also
21 designate Paul Kosturos as Interim Chief Financial Officer,
22 and Josh Jacobs as Interim Chief Operating Officer.

23 We did resolve all the informal comments to this
24 motion. We received two informal comments, one from the
25 Office of the United States Trustee and one from the

1 committee. I can hand up your order -- or Your Honor and
2 order and black-line to walk you through those changes.

3 THE COURT: Thank you.

4 MS. STEELE: Your Honor, turning to the black-
5 line, in Paragraph 4, (h), (i), and (j) are requests of the
6 Office of the United States Trustee. These are typical
7 requests with respect to A&M's retention.

8 The first one is that none of the success fees are
9 pre-approved by the Court, or any back-end fees.

10 The second change is the debtors are permitted to
11 indemnify the executive personnel on the same terms as their
12 D&O policies.

13 THE COURT: Uh-huh.

14 MS. STEELE: And (j) provides, subject to the
15 foregoing, during the Chapter 11 cases, there's no other
16 indemnification of A&M or its affiliates.

17 Paragraph 5 was a requested addition of the
18 committee, and it provides that, at the time of the sale
19 closing, it would be the understanding that most -- that Mr.
20 Kosturos and Mr. Jacobs would no longer be officers of the
21 company; and so they would, at that time, be just charged
22 hourly rates, and not the flat rates that A&M gets for those
23 officers.

24 THE COURT: Okay.

25 MS. STEELE: And with those changes, we are

1 resolved, and we request entry of the order approving the
2 motion.

3 (Pause in proceedings)

4 THE COURT: Okay. Does anyone wish to be heard
5 with respect to the motion to retain Alvarez & Marsal?

6 (No verbal response)

7 THE COURT: Okay. Hearing no one.

8 I reviewed it. Based on the resolution of the
9 issues with the committee and the Office of the United States
10 Trustee, I will approve it as revised.

11 MS. STEELE: Thank you, Your Honor.

12 I now turn the podium back over to Mr. Merchant.

13 MR. MERCHANT: Thank you, Your Honor. Mike
14 Merchant again for the record.

15 Your Honor, the next item I'd like to handle is
16 Agenda Item Number 17, which is the store closing sale
17 motion. I think what's often referred to in the pleadings as
18 the "North American Retail Assets," and what those are are
19 retail store locations in the U.S. and Canada and the related
20 inventory. The debtors have 27 stores in the U.S. and 33
21 retail stores in Canada, and these consist mostly of full-
22 price and outlet retail locations.

23 As detailed at the last hearing in connection with
24 the bid procedures, after a robust pre-petition marketing
25 process, the debtors have selected a stalking horse agreement

1 with CB Marathon OpCo, LLC, which is an affiliate of Charles
2 Bank. The stalking horse bidder is currently not taking any
3 of the North American assets. And based on diligence with
4 other prospective bidders, both before and after the petition
5 date, it does not appear that any bidder will have a
6 significant interest in the North American retail assets.

7 Accordingly, the debtors determined, in the
8 exercise of their business judgment, that it's in the best
9 interest of the estates to conduct store closing sales at
10 each of the North American retail locations, and to commence
11 such sales as soon as possible, so as -- in the hopes of
12 completing such sales by July 31st, and avoiding the
13 incurrence of August rent.

14 THE COURT: Are we past the twenty-five-day period
15 in the agreement?

16 MR. MERCHANT: We are past the twenty-five-day
17 period, Your Honor. And in addition to that, this motion was
18 originally noticed for the hearing on June 5th. We agreed to
19 continue the motion to this hearing at the request of the
20 committee, to allow some additional time for discussions
21 between the stalking horse bidder and the landlord
22 constituency. I understand that some of those conversations
23 are ongoing. But as of this time, the stalking horse bidder
24 has not committed to take any of the North American retail
25 assets.

1 Now the relief requested in the motion, it's
2 authorization; it's not direction --

3 THE COURT: Uh-huh.

4 MR. MERCHANT: -- to conduct those sales. We have
5 the ability to start them -- well, the order is drafted, so
6 that we'd have the ability to start them when we deem
7 appropriate. And in the event that we started them, and
8 circumstances were to change, and it being in the best
9 interest of the estates to stop them at that point in time,
10 based on the interest we're receiving from bidders or the
11 stalking horse bidder, we would have the ability to do that,
12 as well. So that is built into the relief that we're
13 seeking.

14 THE COURT: Okay.

15 MR. MERCHANT: The sales would be -- as is typical
16 with this type of motion, would be conducted in accordance
17 with the standard sale guidelines. Paragraph 3 of the order,
18 however, expressly gives the debtors authority to enter into
19 side letters with landlords to amend the guidelines with
20 respect to specific stores.

21 We have entered into a number of side letters with
22 the U.S. landlords, relating to the sale guidelines.
23 Additionally, with regards to the Canadian landlords, there
24 is a -- I'll call it a "global side letter" that amends the
25 guidelines with regards to all of the Canadian retail

1 locations. And that will be part of, I guess what would be
2 submitted in connection with the recognition hearing later --

3 THE COURT: Okay.

4 MR. MERCHANT: -- this week.

5 As Your Honor is already aware, HYPERAMS will be
6 the company's consultant in connection with the sales. They
7 are truly a consultant, as the company has determined that
8 they have the internal wherewithal and sort of institutional
9 knowledge to conduct these sales on their own. This is not
10 the type of situation where it's a flat-fee deal, with a
11 liquidator coming in and purchasing the inventory up front.

12 We also seek authority to provide stay or shrink
13 bonuses to retail employees. These are managers, assistant
14 managers, and sale associates that works scheduled hours,
15 maintain the store to establish standards, and adhere to loss
16 prevention guidelines. We seek -- as of now, absent further
17 order of the Court, we seek a three-hundred-thousand-dollar
18 cap on any such payments, and they are discretionary bonuses.

19 The amounts paid to different employees would be
20 determined by a collection of HYPERAMS, Mr. Kosturos as the
21 Chief Financial Officer of the company, and Jason Israel, who
22 is in charge of North American retail sales. They've come up
23 with a number of plans relating to that, and will make a
24 determination based on what they think is in the best
25 interests of the debtors and how to maximize the stores and

1 retaining employees through the duration of the sales. There
2 will be no bonus amounts paid to any insiders; we can confirm
3 that for the Court.

4 The motion was noticed on all landlords, state
5 AGs, and the National Association of Attorney Generals.
6 There are currently no objections that I am aware of to the
7 relief requested in the motion.

8 We do, however, have an amended form of order. We
9 have amended the order to address some comments from some
10 landlords. It amends the -- both the order. It also amends
11 the guidelines. If I may approach?

12 THE COURT: You may.

13 (Pause in proceedings)

14 MR. MERCHANT: I'm going to hand up the clean and
15 the black-line, Your Honor.

16 THE COURT: Thank you.

17 MR. MERCHANT: The comments are pretty limited
18 because most of the landlord concerns are addressed in the
19 actual side letters. I can walk Your Honor through the
20 changes, they're brief.

21 The first is to Paragraph 3 of the order, which,
22 basically, this is the provision authorizing the relief, and
23 it says "except as otherwise provided in this order."

24 With regard -- the next change I would note is in
25 Paragraph 9. This is the paragraph which provides that the

1 debtors will be deemed to be in compliance with liquidation
2 state laws. They have added the -- so will the affected
3 landlord, with regards to the applicable closing stores.

4 The next change, Your Honor, is in Paragraph 10.
5 This relates to notice, in the event of any disputes
6 regarding the conduct of the sales, and simply adds the
7 affected landlord as a notice party with regards to any such
8 disputes.

9 Paragraph 14 is an additional paragraph, and this
10 is obviously always the intent and what is required by the
11 Bankruptcy Code. But it says nothing in this order releases
12 the debtors of complying with their obligations under Section
13 365(d) (3) of the Code.

14 And then Paragraph 18, the change there is this is
15 -- this relates to the abandonment relief that we've sought.

16 THE COURT: Uh-huh.

17 MR. MERCHANT: And this simply clarifies that any
18 rejection of the leases will be subject to a further notice
19 and motion. We are not seeking any relief with regard -- in
20 this motion, with regards to rejection of the leases.

21 If Your Honor turns to the attached guidelines,
22 Paragraph 6, again, addresses that concern regarding the
23 rejection of the leases and further notice and a hearing.

24 Paragraph 7, this just relates to the types of
25 language that can used in signage related -- signage or

1 advertising related to the sale. The term "liquidation sale"
2 shall not be used.

3 And I believe that is all of the changes, Your
4 Honor. I'm happy to address any questions that the Court may
5 have.

6 THE COURT: Okay. No, you've addressed the one
7 question I have, which is that there is going to be a hearing
8 before the Canadian Court with respect to the sales that are
9 happening in Canada --

10 MR. MERCHANT: That is correct, Your Honor.

11 THE COURT: -- to ensure that that Court is
12 satisfied that the sales can proceed as requested.

13 MR. MERCHANT: That's correct, Your Honor.

14 THE COURT: Okay.

15 MR. INDYKE: Jay Indyke of Cooley, proposed
16 counsel for the creditors' committee.

17 I just am -- as Mr. Merchant said, the motion was
18 adjourned to this week at the committee's request. Since
19 that time, a couple of things have happened:

20 First, the committee has had full access to the
21 data room, and has had discussions with the debtor and its
22 professionals with respect to the sale process and interested
23 parties.

24 Our initial concern was that store closing sales
25 were going to start before the bid deadline. The bid

1 deadline in the case is set for June 29th; store closing
2 sales would start earlier. We were concerned that that might
3 prejudice things, and might chill bidding, potentially.

4 But since that time, aside from being in the data
5 room, having those discussions with the debtor, the committee
6 had an in-person meeting with the stalking horse in Boston
7 last week, to walk through things. And as a result of that,
8 it appeared that the stalking horse may be interested, and is
9 still in discussions with certain landlords, with respect to
10 taking on leases, potentially, in the United States and
11 Canada, retail leases. We understand that that's a longshot,
12 but it may happen. I understand that, to my knowledge, even
13 today, there were discussions that are going on.

14 Notwithstanding that, the committee understands
15 the economics of the situation. We don't want to push sales
16 into August, creating additional rent. We understand that
17 this is being set up, so that the inventory can be moved out
18 by the end of July, and we wouldn't have to get into --

19 THE COURT: Uh-huh.

20 MR. INDYKE: -- paying August rent.

21 But that, to the extent that there are any
22 agreements cut with the stalking horse, whereby, under their
23 agreement, they would assume any of those leases, as
24 modified, that it might have some impact on what happens with
25 the store closing sales. But that would be something that

1 would have to be negotiated between the stalking horse, the
2 debtor, and the applicable landlord.

3 THE COURT: Uh-huh.

4 MR. INDYKE: Thank you.

5 THE COURT: Thank you.

6 Does anyone else wish to be heard?

7 (No verbal response)

8 THE COURT: Okay. I've reviewed the store closing
9 sales motion, which has been preset since the beginning of
10 the case. I am prepared to approve it on the terms that have
11 been requested, recognizing that there are and may be more
12 side agreements with landlords, with respect to their
13 particular stores, which is, of course, not unusual in these
14 cases; and also appreciate the comments from both the debtor
15 and committee counsel with respect to the possibility, no
16 matter how remote it might be, that the stalking horse bidder
17 or some other party might be interested in these leases.

18 But as things stand at this moment, no one is.
19 And I do think it is appropriate the debtor is appropriately
20 exercising its business judgment to commence these sales.
21 And in the event we're lucky enough to have someone
22 interested, we'll deal with that as it unfolds. So I will
23 approve the store closing sales as modified.

24 MR. MERCHANT: Thank you, Your Honor.

25 THE COURT: That order is signed.

1 MR. MERCHANT: Thank you, Your Honor.

2 The last item on the -- that I will be handling
3 today is actually the last item on the agenda. It's Agenda
4 Item Number 22. And this was styled as the debtors' motion
5 for entry of an order approving a key incentive plan, and
6 that has changed a little bit.

7 THE COURT: Uh-huh.

8 MR. MERCHANT: We received comments to the motion
9 from the committee, and the United States Trustee also filed
10 a formal objection to the motion. We've been in
11 communications with the committee and the United States
12 Trustee over the past week regarding their concerns and
13 objections and discussing some proposed changes to the plan,
14 intended to address these concerns. And much of the U.S.
15 Trustee's objection related to the debtor satisfying their
16 evidentiary burden with regards to the motion.

17 Yesterday, we filed the declaration of Paul
18 Kosturos; he's the Interim Chief Financial Officer of the
19 debtors. He is in the courtroom today, Your Honor, to the
20 extent that you have any questions or anyone would like to
21 cross-examine him. We filed it in support of the motion and
22 in an effort to address a lot of the concerns raised by the
23 committee or raised by the Office of the United States
24 Trustee.

25 In connection with the declaration, the debtors

1 set forth a number of modifications with regards to the
2 plans. The most significant modification, Your Honor, is
3 that the KEIP will be limited to the nine tier one employees
4 that are likely "insiders" of that debtors, as that term is
5 defined in the Bankruptcy Code.

6 With regards to the other 20 "tier two employees,"
7 as we refer to them, we believe they are non-insiders, and
8 Mr. Kosturos' declaration goes as to -- goes into why we
9 believe they are not insiders. The debtors intend to
10 implement a more traditional key employee retention plan; we
11 refer to that as the "KERP," and I can get back to the terms,
12 the proposed terms of the KERP in a moment.

13 With regards to the KEIP itself, and as it would
14 continue, if approved by the Court, with regards to the nine
15 employees, there were some changes that were made in response
16 to the comments and objections that we received:

17 First, with regards to the calculation of
18 aggregate gross consideration under the KEIP, we've agreed
19 that that calculation will not include assumed liabilities
20 under any qualifying transaction.

21 Bonus amounts under the KEIP will be capped at the
22 two-hundred-and-ten-million threshold. Of course, the target
23 bonus was set at the one-hundred-and-seventy-million
24 threshold.

25 THE COURT: Uh-huh.

1 MR. MERCHANT: But the KEIP, as originally
2 drafted, referenced, I believe in a footnote, the possibility
3 of additional bonus amounts, if the sale proceeds would go
4 above two ten.

5 THE COURT: Yes.

6 MR. MERCHANT: We've capped it at two ten. That
7 would be a great problem to have, Your Honor. But we have
8 agreed to that, in response to the objection we received.

9 We've agreed that the committee will have consent
10 rights with regard to the calculation of aggregate gross
11 consideration. In the event that we're unable to reach
12 agreement as to the calculation of that amount with the
13 committee, I think all the parties agree that we can bring
14 that issue before the Court.

15 In response to a comment from the committee, in
16 order to receive a bonus amount -- and this would apply to
17 both the KEIP and the KERP. Participants will be required to
18 first waive any claims that they may have to severance or any
19 other incentive bonus amounts. The economics of the proposed
20 KERP, Your Honor, otherwise remain the same. Assuming the
21 aggregate gross consideration level reaches 170 million, such
22 that the target bonus amount would be paid, the aggregate
23 cost of the KEIP would be \$1,741,600.

24 With regards to the KERP, KERP bonus payments
25 would be subject to participants remaining employed by the

1 debtors through the closing of a sale -- and it doesn't
2 necessarily need to be a qualifying transaction, as was the
3 case with the KEIP -- and the completion of the store closing
4 sales. But to be clear, if participants transition to the
5 buyer at closing or are terminated without cause, post-
6 closing, because they are no longer needed in the final
7 stages of the store closing sales, they would still be
8 entitled to their KERP bonus.

9 The KERP bonus amounts are set what is the target
10 bonus amounts under the original KEIP. So the KERP bonus for
11 each of the 20 participants is actually set at what would
12 have been the total bonus amount, with an aggregate gross
13 consideration level of 170 million, so that's how the amounts
14 were determined.

15 The total cost of the KERP is \$748,313, with an
16 average KERP bonus of \$37,416 per participant. The detailed
17 terms of the KEIP, as revised, and the KERP are attached to
18 the Kosturos declaration, and they will also be attached to
19 the revised form of order that I will hand up.

20 Before addressing any questions that Your Honor
21 may have, or walking Your Honor through the black-line,
22 however, I would like to move the Kosturos declaration into
23 evidence in support of the motion.

24 THE COURT: Does anyone object?

25 (No verbal response)

1 THE COURT: I hear no objections. Mr. Kosturos'
2 declaration is admitted without objection, and I did review
3 it.

4 (Kosturos Declaration received in evidence)

5 MR. MERCHANT: Thank you, Your Honor.

6 If I may approach, I can hand up a clean and a
7 black-line of the form of order.

8 THE COURT: You may.

9 MR. MERCHANT: The changes, Your Honor, look a
10 little heavy in the front of the order, and these are just
11 simply recitals to reflect the filing of the U.S. Trustee's
12 objection, the receipt of comments from the committee, and
13 the filing of the Kosturos declaration, and then to introduce
14 the fact that the KEIP was -- has been amended to be limited
15 to the nine employees, and that there is now a proposed KERP.

16 The other changes, Your Honor, probably go to the
17 so-ordered paragraphs, and simply reflect that the form of
18 the KEIP is now attached as Exhibit A. And to implement the
19 KERP and approval of the KERP, which is also detailed in the
20 attached Exhibit A, which is the same exact -- Exhibit A that
21 was attached to the Kosturos declaration.

22 Paragraph 5, Your Honor, is the paragraph I talked
23 about with regards to the committee comment, which simply
24 makes clear that any payments under the KEIP or the KERP
25 shall be in lieu of and subsume any severance payment or

1 other incentive or retentive-based bonus payment to the
2 participants, and that they'll be required to waive such
3 amounts in order to receive their bonuses under the KEIP or
4 the KERP.

5 And Paragraph 6, Your Honor, this relates to the
6 committee's role in determining the aggregate gross
7 consideration level with regards to the KEIP.

8 I'm happy to address any questions that Your Honor
9 may have.

10 THE COURT: I do not have any questions.

11 Does anybody wish to be heard with respect to the
12 employee KERP and KEIP motion?

13 (No verbal response)

14 THE COURT: Okay. As I indicated, I reviewed the
15 Kosturos declaration, which was quite thorough with respect
16 to how these programs were developed, and the professionals
17 that were consulted with respect to appropriate amounts of
18 these types of programs, both pre- and post-bankruptcy, as
19 well as the amendments that have been made to the program,
20 particularly the separation of the program into a KEIP and a
21 KERP. And based on the declaration, the resolution of the
22 objections to the -- made by the Office of the United States
23 Trustee and the comments received from the committee, I find
24 that these programs are appropriate, and I will approve the
25 order.

1 To the extent necessary, they meet the
2 requirements of Section 503 and 363, and I find that they are
3 incentive-based programs, properly incentive-based. And to
4 the extent they have retentive effects, they are collateral
5 to the purpose of the programs, and I will sign the revised
6 order.

7 MR. MERCHANT: Thank you, Your Honor.

8 This concludes the matters that I'm handling
9 today. If acceptable to the Court, may I be excused?

10 THE COURT: You may.

11 MR. MERCHANT: Thank you, Your Honor. I believe
12 Mr. Collins will handle the next matter and get back to the
13 DIP.

14 (Participants confer)

15 MR. COLLINS: Your Honor, turning to the final
16 hearing on our motion to approve debtor-in-possession
17 financing. Your Honor, we did receive two objections: One
18 filed by Richter's Advisory Group, which is acting as the
19 information officer in the ancillary proceeding for Rockport
20 Canada ULC --

21 THE COURT: Uh-huh.

22 MR. COLLINS: -- as well as a -- what I would call
23 a "fairly comprehensive objection" from the creditors'
24 committee to approval of the final DIP facilities.

25 I'm very pleased to report, as I noted at the

1 outset, that the committee has reached a global compromise,
2 related -- I view it as a case compromise, on how we move
3 forward with the noteholders, as well as, to some extent, the
4 ABL lenders.

5 And I do, you know, want to thank counsel for the
6 committee, as well as the noteholders, for working very
7 diligently over the weekend and prior to that, to see if we
8 could reach a deal that was helpful to the estates, and to
9 facilitate these cases moving forward on a consensual basis,
10 as much as possible.

11 Your Honor, the form of our reply did note some
12 unilateral concessions that the noteholders had agreed to,
13 including limiting the go-forward roll-up to dollar-for-
14 dollar, so only any new one dollar of DIP lending they make,
15 there is a one-dollar roll-up. That one-dollar roll-up does
16 not take liens on unencumbered assets; however, obviously,
17 the new money one dollar would. And again, that's only for
18 the amount of dollars actually lent. So, if we only borrow
19 an additional \$5 million out of the 10 million committed, if
20 there were to be a five-million-dollar new money loan on the
21 unencumbered assets, five-million-dollar roll-up, but that
22 would not attach to unencumbered property.

23 The noteholders and the ABL have agreed to
24 eliminate liens as superpriority administrative claims on
25 avoidance actions and commercial tort claims, except for

1 Section 549 actions, and only for reimbursement of carveout
2 monies actually used to pursue recoveries.

3 The parties have agreed to increase the
4 investigation budget of the creditors' committee from 50,000
5 to 100,0000. And there has also been an increase in the
6 budget of professional fees for the creditors' committee
7 professionals that accrue prior to the closing of a
8 transaction.

9 Your Honor, what I would like to do is turn the
10 podium over to Mr. Indyke to walk Your Honor through the
11 additional terms that have been agreed to.

12 We certainly -- if Your Honor does ultimately
13 approve the facility, we will need to spend time revising the
14 form of order, attaching the terms of this agreement. The
15 terms would be an exhibit to the DIP order, as I'm
16 contemplating it, as it would leave money behind from the
17 lenders in the estate upon the closing, for us to accomplish
18 an appropriate plan process and wind-down of the debtors'
19 entities.

20 THE COURT: Okay.

21 MR. INDYKE: So, with that, Your Honor, if I could
22 turn the podium over to Mr. Indyke.

23 THE COURT: Yes.

24 MR. INDYKE: Thank you, Your Honor.

25 We were very concerned that the relief the debtor

1 was seeking under the financing order was going to, not only
2 preclude the unsecured creditors from any recovery, but would
3 also potentially lead us down the road of administrative
4 insolvency. And so our goals in negotiating with the debtor
5 were to solve those issues, recognizing the other economics
6 of the case.

7 And starting last week, we engaged in discussions
8 with counsel for the debtor and counsel for the noteholders
9 in what we viewed as something comprehensive, given the
10 relief that was requested; for example, the request for no
11 marshaling, the complete roll-up, all of those issues that
12 would precluded us from any recovery.

13 So what I'm pleased to report is that, after
14 several days of intensive negotiations, we have reached an
15 agreement on a compromise that really does resolve case
16 issues, as Mr. Collins says. And we want to thank Mr.
17 Collins' for his participation, Ms. To, and Mr. Sandler --
18 who can't be here today; I understand his father is
19 undergoing surgery -- were all very helpful in getting us to
20 where we are now. The only thing that we weren't able to do
21 is put it all down in writing, so I could present it to you.
22 So we worked on a termsheet.

23 So, Your Honor, I have a -- my iPhone up here, but
24 this is not to make a call. It's because I have the outline
25 of the termsheet. And what I'm going to do is kind of read

1 from the termsheet, but also editorialize a little bit, to
2 explain why we did various things. And also, there were a
3 couple of things that needed to be added to this email that
4 we were doing. And as Mr. Collins said, the intent is to
5 reduce this termsheet to an exhibit that would be attached to
6 the financing order.

7 So the first thing is that, with respect to any of
8 the terms that I describe, they're all subject to either the
9 stalking horse deal closing on its terms, or some higher or
10 otherwise better bid obtained through the sale process
11 closing; and with the understanding that, in the event that
12 there is a total meltdown, the stalking horse walks away, and
13 we have no other bidder, we're back to the drawing board.

14 Critically for us, especially in light of -- we
15 looked at the asset purchase agreement, and we were very
16 concerned in seeing what's going on in the Toys 'R Us case in
17 Virginia. And in that case -- and we're not involved in
18 that, representing any of the major parties. We understand
19 it was a very robust critical vendor program. Vendors
20 shipped in hundreds of millions of dollars of inventory post-
21 petition. And then a decision was made in the early part of
22 this year, before there was repayment on the post-petition
23 debt, in part or in full, to liquidate the company.

24 And the Court actually entered an order
25 bifurcating the payment of administrative claims between

1 wind-down and pre- a certain period. So there was a real
2 risk in that case, as we understand it, of hundreds of
3 millions of dollars of post-petition debt that will be
4 unpaid, and not otherwise satisfied.

5 And we were concerned, especially in light of the
6 fact we understand the critical vendor program and the
7 foreign vendor program were very important to the debtor in
8 this case, to keep continuity, to maintain going concern
9 value. These critical vendor programs that have been
10 approved, and that we support, provided for up to \$22
11 million, I believe, in total going out. But in exchange for
12 that, the vendors were committed to shipping the company
13 going forward on regular terms; not on shortened terms, but
14 on regular terms going forward, with many of those terms
15 expiring beyond the anticipated closing date of any sale
16 transaction.

17 And we looked at the budget, and we said, well,
18 okay, let's look at the budget and let's look at the stalking
19 horse agreement. The stalking horse agreement is excellent,
20 in that it says that, aside from cash consideration that is
21 being paid by the stalking horse, they're also assuming a
22 substantial number of liabilities, including all of these
23 post-petition trade payables, which, under the budget, is --
24 could be as high as \$25 million.

25 However, what we were concerned is that, what

1 happens if there's an alternative bid that came around, and
2 the bidder did not want to pick up these liabilities. Then
3 we might have a situation where the secured debt would be
4 paid, we wouldn't have enough funds, we'd be administratively
5 insolvent. We'd have these creditors in exactly the same
6 situation as the creditors were left with in the Toys 'R Us
7 situation. And these are vendors that have been supporting
8 this business, providing inventory that's collateral for the
9 lenders going forward, but yet, wouldn't be paid for it post-
10 petition.

11 So what we've -- part one of the key items of the
12 agreement that we have is that, on the closing of the sale
13 transaction, there are going to be funds left in the estate
14 to pay ordinary course administrative claims that accrued
15 prior to closing, for whatever reason, that are not assumed
16 by the stalking horse or any successful bidder. And this
17 should be within the budgeted amounts. We think the debtors
18 provided budgeted numbers to the committee, to the
19 noteholders that they believe are pretty accurate.

20 This is also intended to pick up 503(b)(9) claims,
21 which may be very limited in this case, non-critical vendor
22 503(b)(9)'s or 503(b)(9)'s that, for some reason, haven't
23 been paid under critical vendor. It would pick that up, as
24 well. So that was a critical part of what we negotiated.

25 Sorry, while I bring up the rest of this, Your

1 Honor.

2 The -- in addition, other terms are that the
3 noteholders agree to fund a wind-down reserve, with sale
4 proceeds in the amount of \$2.5 million. The reserve will be
5 used to pay professional fees and other administrative costs
6 incurred after the sale closing, to prepare and confirm a
7 plan of liquidation consistent with the proposed settlement,
8 and also administrative and priority claims that have not
9 been paid in the ordinary course, or not assumed by the
10 buyer.

11 The unused amount of the reserve will go into a
12 trust for unsecured creditors, referred to the acronym "GUC
13 Trust," meaning general unsecured creditor trust. So, if I
14 refer to "GUC" going forward, that's what I mean by that.

15 In addition, I think Mr. Collins noted that the
16 creditors' committee professional fee budget is being
17 increased during the pre-closing period, up to \$750,000. I
18 don't think he set forth a number, but that's the number. I
19 think that's from a number that was less than \$400,000 in the
20 original budget. Any unused amount of the budgeted
21 creditors' committee professional fees will go into the GUC
22 Trust.

23 The GUC Trust is also going to be funded with
24 commercial tort claims and avoidance actions and other claims
25 that are not taken by any purchaser, except claims arising

1 under Section 549 of the Bankruptcy Code. Any unused amount
2 of the wind-down reserve and budgeted professional fees will
3 also be -- go into that trust.

4 If the auction -- this is another important
5 feature, especially in light of what we've seen recently in
6 another footwear-related case, Nine West, where there was a
7 stalking horse bid of \$220 million. They just concluded an
8 auction over the weekend. I understand the winning bid was
9 \$350 million. We wanted to ensure that, to the extent that
10 this bidding was that robust, that there would be something
11 that would be made available and put into this GUC Trust, as
12 well.

13 So, if the auction produces a net increase in cash
14 consideration received by the debtors, meaning after payment
15 of any breakup and expense reimbursement to the stalking
16 horse in excess of \$10 million above the current stalking
17 horse price, the -- there would be provided to the GUC Trust
18 5 percent of any increased value -- I'm sorry -- 2.5 percent.
19 I skipped something. It would be 2.5 percent between ten and
20 \$20 million, would be put into the GUC Trust. And if the
21 number ends up being in excess of \$20 million, anything in
22 excess of \$20 million, it would be 5 percent.

23 And this is in recognition -- there was back-and-
24 forth, as in all negotiations. We asked for more. But we
25 understand that the noteholders are significantly under water

1 in this case, at least under the present stalking horse
2 proposal.

3 In addition, the noteholders, given the fact that
4 they are going to be presumably, at least under the --
5 certainly under the stalking horse bid, substantially
6 undersecured, they're going to have a significant deficiency
7 claim. That's probably going to dwarf the rest of the
8 unsecured debt in this case. We wanted to ensure that, as
9 part of the settlement, we weren't just getting money in,
10 just to pay them all back.

11 So the agreement provides that the deficiency
12 claim -- any deficiency claim that the noteholders file will
13 not receive any distribution under the GUC Trust, until the
14 aggregate distributions by the GUC Trust exceed \$2 million.
15 So there would first be the first \$2 million goes to all
16 other GUC before any distribution is made to the noteholders.
17 And thereafter, the deficiency claim can participate with
18 respect to any other distributions that are made. And I am
19 noting there are causes of action that were transferred to
20 the trust. We don't know, we're not putting any kind of
21 value on that right now, but we know that that is an area of
22 potential recovery.

23 The committee is agreeing to support a liquidating
24 plan that is consistent with the terms of this proposed
25 settlement. The plan is going to include broad releases in

1 favor of the noteholders and related parties in all
2 capacities.

3 The committee will further support any request by
4 the debtor for an expedited combined plan and disclosure
5 statement process. I feel like Mr. Collins didn't mention it
6 yet, but I assume he will at some point.

7 Also, to the extent that our objection can be read
8 as one to the debtors' proposed allocation on the ABL with
9 the Canadian entity, we withdraw that objection and support
10 the debtor.

11 And in addition, the -- as part of this, as part
12 of what I've described, the noteholders' concessions,
13 including, I think as described by Mr. Collins previously, no
14 lien or superpriority claim on commercial tort claims and
15 avoidance actions and other claims that are not going to any
16 purchaser, except claims arising under 549, and for -- and
17 with respect to the roll-up.

18 One additional item, Your Honor, is that the
19 committee had filed an object to -- a limited objection to
20 the Houlihan retention. As part of the universal deal that
21 we've reached, we have agreed to withdraw that objection, the
22 limited objection.

23 And Your Honor, with that, that is -- that, in
24 toto -- and again, this is subject to any -- there have been
25 other people -- I'm just reading from a termsheet. There may

1 be other people here in court today that may want to clarify;
2 Ms. To may want to say something. But this is our
3 understanding of what it is.

4 THE COURT: Thank you.

5 MR. INDYKE: Thank you, Your Honor.

6 THE COURT: Ms. To.

7 MS. TO: Your Honor, good morning. My Chi To with
8 Debevoise & Plimpton for the noteholders.

9 So I agree with Mr. Indyke's summary. I only had
10 a few clarifications to add.

11 With respect to the comment that, if the sale
12 doesn't close, we're back to the drawing board, we certainly
13 hope not to be there. But I wanted to clarify that the final
14 DIP order that would be entered into today would be final.
15 So we're back to the drawing board, in terms of resolving the
16 ultimate case, in terms of distributing value among the
17 stakeholders. That's the first clarification; the second one
18 relating to the DIP.

19 Mr. Indyke summarized accurately the concessions
20 the noteholders are willing to do with respect to the
21 incremental funding and related roll-up. But with respect to
22 the \$30 million of DIP notes that exist today, the ten-
23 million-dollar new value plus the twenty-million roll-up,
24 those notes would benefit from the protections we baked in
25 the interim order that would become final.

1 The only exception is that we agree that, as Mr.
2 Indyke explained, there would be no lien on avoidance
3 actions, except under 549, and no lien on commercial tort
4 claims. But the initial 30 million would benefit from a lien
5 on the unencumbered foreign stock, to the extent there is any
6 value there.

7 And last, I'm not sure that Mr. Indyke clarified
8 this, but with respect to the committee's professional fees,
9 we agree, obviously, with the increase of the budgeted amount
10 to seven hundred fifty. The investigation budget of 100,000
11 would be included in that seven fifty.

12 THE COURT: Okay.

13 MS. TO: Thank you.

14 THE COURT: Thank you.

15 Anyone else, with respect to that particular deal?

16 (No verbal response)

17 THE COURT: Okay.

18 MR. COLLINS: So, with that, Your Honor, I think
19 we can confirm that the committee's objection is withdrawn,
20 obviously subject to submission of an agreed-upon form of
21 order.

22 Your Honor, before turning to the sole remaining
23 objection of the information officer, we did, yesterday, file
24 a black-line of our proposed final DIP order.

25 THE COURT: Yes.

1 MR. COLLINS: I'm happy to walk Your Honor through
2 some of the material changes, if Your Honor would like, if
3 Your Honor had any questions.

4 I would also note that Your Honor raised some
5 questions at the interim hearing on certain provisions of the
6 DIP that you wanted us to bring back to Your Honor's
7 attention at today's hearing. So, if I could Your Honor, it
8 might be helpful to simply hand up a copy of the black-line,
9 and maybe spin through it very quickly.

10 THE COURT: I've got the black-line.

11 MR. COLLINS: Okay.

12 THE COURT: I have not had a chance to take a look
13 at it.

14 MR. COLLINS: Okay. Great. So, if I could, Your
15 Honor, just maybe walk you through some of the key
16 provisions. Obviously, a lot of the changes simply conform
17 this order from an interim order to a final order.

18 Your Honor, the first change that I'd like to
19 point out to Your Honor is starting on Page 25 and 26. And
20 I'm hoping Your Honor has the same pagination that I do on my
21 order.

22 THE COURT: Okay.

23 MR. COLLINS: So this -- it's really -- in my
24 version, it's at the bottom of Page 25, going over to 26.
25 This is where we talk about these additional new money notes,

1 you know, the dollar-for-dollar --

2 THE COURT: Uh-huh.

3 MR. COLLINS: -- that would be approved going
4 forward for any borrowings after the final hearing.

5 You will note, Your Honor, on Page 27, we have
6 excised commercial tort claims from the liens being granted
7 to the ABL lender in that circumstance.

8 Page 29, similar concept with respect to
9 commercial tort claims and avoidance actions -- I'm sorry --
10 and also to note that the additional roll-up notes shall
11 extend -- let me make sure I have this right. Right. So
12 this is to clarify that the additional roll-up notes do not
13 take liens on unencumbered assets. And again, that's the
14 dollar -- that dollar roll-up.

15 We've clarified, on Page 30, that there were not
16 liens on avoidance actions, only -- but only to the extent of
17 Section 549, and to the extent there have been funds lent by
18 the lenders out of the carveout that were used to seek to
19 recover preference actions. I don't believe that will happen
20 in this circumstance, Your Honor.

21 Your Honor, the first provision that Your Honor
22 wanted to take a look at again is Page 32, Paragraph 9. This
23 is in, you know, the litany of claims that a DIP
24 superpriority claim would be senior to, and we had Section
25 365 in there. Your Honor questioned, is that appropriate.

1 So what we did is we put it out on notice. There have been
2 no objections. And so I wanted to point that out for Your
3 Honor's consideration for entry of the final order.

4 THE COURT: Thank you. Okay.

5 MR. COLLINS: Turning to Page 34, similar issues,
6 Your Honor, with respect to these, the litany of claims that
7 will be subordinated to the superpriority claim of the ABL
8 secured parties. We have 546(c) in there and 546(d), both of
9 which Your Honor asked us to put out on notice, subject to
10 entry of the final order.

11 THE COURT: Okay.

12 MR. COLLINS: Identical issue, Your Honor, Page
13 36, with respect to the secured notes superpriority, again,
14 noting 546(c) and 546(d) as being subordinate to that
15 superpriority admin claim.

16 Turning to Page 51, we have deleted Paragraph 34.
17 We did -- Your Honor, also at the interim hearing, raised
18 some concerns about potential inconsistencies between this
19 paragraph and a later paragraph, I want to say it's paragraph
20 forty -- 47, so -- and we also received some comments from
21 landlords. So we've deleted this paragraph in its entirety
22 to --

23 THE COURT: Okay.

24 MR. COLLINS: -- to streamline and make it more
25 clear.

1 Page 52 reflects the hundred-thousand-dollar
2 number for the committee, for investigation.

3 Turning to Page 54, the proscribed actions. Your
4 Honor had concern about the breadth of this provision. I do
5 note that I think this will be part of the discussion that we
6 have in submitting the final order, to make sure everybody
7 understands kind of the rules of the road with respect to the
8 intent and terms of this paragraph. So I know that's
9 something that the committee wanted to speak with the lenders
10 about. So my guess is we'll have some changes to this that
11 we'll submit to Your Honor with a black-line reflecting those
12 changes.

13 THE COURT: Okay.

14 (Pause in proceedings)

15 MR. COLLINS: Finally, Your Honor, I think, is the
16 survival paragraph, Page 49. Your Honor raised concerns
17 about this. I don't remember in what context, but I wanted
18 to make sure that we flagged it for Your Honor's, you know,
19 review, once again.

20 THE COURT: What page is that on?

21 MR. COLLINS: Page 65 of my version.

22 THE COURT: 65. Okay.

23 (Pause in proceedings)

24 THE COURT: Okay.

25 MR. COLLINS: Your Honor, since the filing of that

1 black-line on the docket, we have had some limited
2 communications with the information officer on their comments
3 to the form of order, not that it resolves their objection.
4 But regardless of the outcome of that objection, they wanted
5 certain provisions put into the order, which we certainly
6 considered.

7 What I would like to do, Your Honor, is to hand to
8 you the same version of the revised changes to the inserts
9 that the information officer provided because I think it will
10 provide you with some understanding as to what we have done,
11 not that it has been agreed to, but I want to show Your Honor
12 what we have sent to them. It's kind of the baseline of
13 where we are right now.

14 THE COURT: Okay. Thank you.

15 (Participants confer)

16 MR. COLLINS: So, Your Honor, what we've done in
17 paragraph 39 is to clarify what we believe the allocation --
18 ABL liability allocation should be, and that is 18.4 percent
19 of the ABL obligations, which we currently estimate to be
20 R10.48 million-dollars.

21 That number has moved -- the 18.4 percent is
22 fixed. That comes out of the most recent borrowing base
23 certificate prior to the petition date. I would note that
24 the most recent borrowing base certificate, as of the day
25 after the petition date, is actually higher than 18.4

1 percent. It's like 19.8 percent. But because we have
2 noticed the pleading at 18.4 that is what we're going to stay
3 with as our proposal.

4 The ABL debt itself or the numbers moving on a
5 little bit, there is, obviously, the principal that I think
6 we can agree to. There is a letter of credit that was issued
7 under the prepetition ABL facility of \$3.55 million dollars.

8 Expeditors was the beneficiary of that letter of
9 credit. They, in fact, drew down \$2.5 million-dollars of
10 that letter or credit, so we think that should be additive to
11 the ABL number. And there's that remaining one million
12 dollars of LC out there as well.

13 MR. COLLINS: One of the comments that I believe
14 that the information officer had was to ensure that the
15 charges, the administrative charges, on account of the
16 Canadian ancillary proceeding, would be senior to the ABL
17 allocation. So, that would have to be paid and that's what
18 we've agreed to in this language.

19 So, really, what it accomplishes is, if the sale
20 proceeds allocation at the end of the day is insufficient to
21 pay the charge, as well as the \$10.4 million --

22 THE COURT: Uh-huh.

23 MR. COLLINS: -- then that allocation basically
24 gets reduced, and so there's more funds to pay the
25 administrative charge.

1 I would also note, Your Honor, because I think
2 it's important, the Canadian entity is a Chapter 11 debtor in
3 these cases.

4 THE COURT: Uh-huh.

5 MR. COLLINS: We've filed an ancillary proceeding
6 up in Canada. The Court recognized that proceeding -- I
7 believe, recognized this as the main proceeding; the center
8 of main interests were identified as being in the United
9 States.

10 As a result, counsel, who represents all of the
11 debtors' estates, including the Canadian entity that is my
12 client, that is also true for the creditors' committee.

13 Their constituency also includes the Canadian
14 unsecured creditors. So, this is not a situation where it
15 is, in essence, the committee and the debtor against the IO.
16 We have fiduciary duties to the Canadian estate, just like we
17 do to the U.S. estates.

18 And that is why when we proposed the ABL
19 allocation, we want to be very clear about the methodology in
20 which we went about doing it, why we're doing it, put it
21 before the Court for consideration and approval. We would be
22 asking the Court, if Your Honor approves it, to be brought to
23 the Canadian Court for recognition.

24 And, obviously, all this does -- and we'll get
25 into argument later -- what this does is simply apportion the

1 liability of the ABL debt amongst the borrower's liable
2 entities, which are the U.S. entities and the Canadian entity
3 on that say, \$57 million of ABL debt, so that each entity
4 pays its fair share and no unsecured creditors of those
5 entities are treated inequitably with one paying more than
6 the other for their allocable portion of that joint and
7 several liability.

8 THE COURT: How does the resolution, the
9 committee's resolution that was just put on the record,
10 address the unsecured creditors of the Canadian entity?

11 MR. COLLINS: Fair question, Your Honor. We spoke
12 about this yesterday and had communications with both, the
13 information officer and the creditors' committee about this.

14 How I view it is that the Canadian creditors would
15 at least participate pro rata in any distributions to
16 unsecured creditors in these cases. I believe that would be
17 their floor. Recall that the noteholders do not have liens
18 or claims --

19 THE COURT: Uh-huh.

20 MR. COLLINS: -- against the Canadian entity. So,
21 it's possible that once we get -- once we understand the
22 sale, understand the assets that are being sold and then
23 reach, hopefully, a compromise on how you allocate amongst
24 the various estates, that the Canadian creditors might very
25 well do better than the creditors that are subordinated to

1 the noteholder debt. And that is a process that we will
2 undertake as we -- I think we'll have informal dialogue
3 before we get to the sale. Once it's come in, then we'll
4 also, I think, we'll have communications about that, but the
5 goal is to come up with a share allocation and then leave
6 open how we then move forward with the debtors' estates. It
7 very well could be that the funds up in Canada are
8 significant enough that it makes sense to simply file any
9 bankruptcy case entirely in Canada, dismiss the Chapter 11
10 case here, and allow the distribution of proceeds to be done
11 in accordance with Canadian law, if that makes economic sense
12 to incur those expenses to file a plenary proceeding, rather
13 than have it simply ride along with our larger plan process
14 for all of the other debtor obligors.

15 As I noted, Your Honor, you know, the noteholders,
16 as the new-money DIP lenders -- and clearly they have an
17 incentive to make sure that this allocation is done fairly --
18 they're putting new money in. They want to know that the
19 Canadian entity that they don't have liens on or claims
20 against will pay its fair share of the ABL debt that it's
21 liable for. And that's been a condition by them of money --
22 new-money lending, post entry of a final order.

23 They initially -- I think, initially, it was first
24 discussed that, well, we need to have this decided before we
25 lend dollar one on the DIP and we knew that couldn't be

1 accomplished with appropriate due process and the like. So,
2 they agreed to put in the 10 million of new money without
3 this issue being resolved, but it was with the agreement
4 that, all right, but we'll at least get this resolved at the
5 final hearing before we put additional monies in, because as
6 Your Honor will recall, we needed new money -- 10 million of
7 new money that, in fact, had been utilized during the interim
8 period.

9 So, with that, Your Honor, unless Your Honor has
10 any preliminary questions, what I would do is turn to
11 testimony. We submitted the declaration of Paul Kosturos.
12 He's in the courtroom. We plan on putting him on direct,
13 along with Nathan Court of Houlihan to walk Your Honor
14 through the process of where we are today and then, I think,
15 turn to argument.

16 I think there was full briefing in our reply as to
17 the manner and the reasoning for why we have proposed this
18 allocation, why we think it's appropriate, why we think it's
19 fair, why we think it's necessary. And so with that, Your
20 Honor, unless anybody has any preliminary comments, I would
21 turn to testimony if that's acceptable to Your Honor.

22 THE COURT: Normally, I would say put the
23 testimony on, but I think I want to hear the testimony in
24 some context, here.

25 MR. COLLINS: Okay.

1 THE COURT: Because I do have a lot of questions
2 and it starts with, what's the standard? Who has the burden?
3 What -- because this an unusual request --

4 MR. COLLINS: Uh-huh.

5 THE COURT: -- and I want to make sure I really
6 understand -- apart from the calculations, which I assume are
7 all correct -- I want to understand what we're doing here
8 because it's -- it strikes me that the -- you know, the ABL
9 lender is not giving anything up, so are we establishing a
10 floor? Are we establishing a ceiling? What if the assets
11 don't come in at enough to cover the 18.4 percent, is the ABL
12 lender giving that up?

13 MR. COLLINS: Sure.

14 THE COURT: I want to understand the things that I
15 don't understand from the papers.

16 MR. COLLINS: Okay. And I'm happy to answer those
17 questions, Your Honor.

18 THE COURT: And this isn't the argument part, but
19 I need to understand that, I think, before I hear the
20 testimony.

21 MR. COLLINS: Okay. So, with respect to how -- I
22 think from the ABL perspective, respectfully, they're
23 somewhat agnostic to this.

24 THE COURT: Uh-huh.

25 MR. COLLINS: They are going to get paid in full.

1 They have the right to look to any of these borrowers for
2 every penny in order -- until they get paid. So, I think
3 they looked back and said, Okay, you can allocate it however
4 you want, whatever you think is fair, but I have a first lien
5 and I'm getting paid at closing in full. And that's where it
6 stands.

7 If the Canadian proceeding at the allocation and
8 of the day is less than an amount sufficient to pay the ABL -
9 - their portion of the ABL debt, then the U.S. entities pick
10 up that portion, because they're totally and severally
11 liable. So, I think that answers that question.

12 THE COURT: So, they don't forego it by the
13 allocation, so the purpose of the allocation is what?

14 MR. COLLINS: So, the purpose of the allocation is
15 that you have the noteholders putting in new money into the
16 U.S. borrowers. The Canadian entity is not even a DIP
17 borrower. They're not liable on the DIP. They're not liable
18 on the prepetition notes.

19 So, they're looking at their borrower, the U.S.
20 borrowers --

21 THE COURT: Uh-huh.

22 MR. COLLINS: -- and saying, okay, what is the
23 capital structure? What are their liability that I'm lending
24 in subordinate to --

25 THE COURT: Right. They're structurally

1 subordinated to the unsecured creditors of the Canadian
2 entity. The pre -- on the pre --

3 MR. COLLINS: True. On the pre, I guess --

4 THE COURT: The noteholders --

5 MR. COLLINS: Do not have a recovery --

6 THE COURT: -- are structurally subordinated to
7 the unsecured creditors of the Canadian entities.

8 MR. COLLINS: Yeah, the Canadian sits down below
9 with Rockport company; you're absolutely right.

10 THE COURT: And they have to get paid in full
11 before anything would go up and be payable.

12 MR. COLLINS: We agree. We agree.

13 THE COURT: Okay.

14 MR. COLLINS: One caveat to that is there is an
15 intercompany claim that the U.S. entities have against Canada
16 --

17 THE COURT: An unsecured claim, as I understand
18 it.

19 MR. COLLINS: And that we'll share, we assume, *pro*
20 *rata* --

21 THE COURT: Yes.

22 MR. COLLINS: -- with all the other unsecured
23 creditors. We do believe the valid claim was for goods sold
24 to Canada that the Canadian entity did not repay by the full
25 time we filed.

1 So, as the noteholders both, from their new money
2 perspective, as well as their adequate protection, right --
3 because they're using -- we're also using our cash collateral
4 to fund these cases -- they're looking at their borrower and
5 saying, How am I going to get repaid on my new-money DIP and
6 my adequate protection and, really, where's the prepetition
7 debt simply stand?

8 And we're looking at \$57 million of ABL priority
9 debt on the ABL priority collateral which counts receivable
10 inventory.

11 THE COURT: Uh-huh.

12 MR. COLLINS: And they see Canada jointly and
13 severally liable for that. They're looking at it and saying,
14 Okay, of this 57 million, how much of this is my borrower
15 paying on it and how much is Canada paying on it? Because if
16 the U.S. is paying all of it, then I have a problem and I may
17 not make this loan because my adequate protection is at risk,
18 my payment on the prepetition secured -- everything falls --
19 every dollar that the U.S. pays more than its share is a
20 dollar necessarily out of the pocket of the noteholders.

21 THE COURT: Uh-huh.

22 MR. COLLINS: So, we looked at that and said, That
23 is a fair ask by a learn who's making loans and cash
24 collateral available to a borrower. How much of the debt is
25 my borrower going to pay and how much are the other co-

1 borrowers -- co-liable obligors going to pay?

2 And what we did -- it's very simple, Your Honor --
3 and we looked at every dollar, net dollar that Citizens lent.
4 There was a net-borrowing based calculation. The Canadian
5 inventory, Canadian receivables are part of that base, just
6 like the U.S. inventory and they are. And you needed both
7 pools of collateral to generate up to \$60 million of
8 availability.

9 THE COURT: Uh-huh.

10 MR. COLLINS: When we looked at the most recent
11 borrowing base, prior to the petition date, 18.4 percent of
12 the net borrowing base was attributable to Canada and the
13 other 86.6 -- whatever it is 17.7 -- whatever it is.

14 THE COURT: Whatever the number is.

15 MR. COLLINS: Whatever it is, it's a lot --

16 (Laughter)

17 MR. COLLINS: -- is attributable to the U.S. And,
18 again, that's -- that is looking at a liquidation scenario
19 from the Citizens perspective. If I have to get out of this
20 debt, out of this facility, how am I protected?

21 And in order -- their number said I'm going to get
22 18.4, percent, basically, of my needed recoveries to pay me
23 in full from the Canadian collateral and I'll get the balance
24 from the U.S.

25 And we looked at it and we said, It seems

1 logically sound. It was objective. It was based upon
2 formulas negotiated by represented parties. We looked at it
3 from the fact that was Canada a net user of the DIP facility
4 or did it never really need the money on the DIP and then
5 that might change your opinion, but we have testimony to show
6 that they certainly were a net user of the DIP facility; in
7 fact, we believe, based upon the intercompany, that they
8 really borrowed, if you look at it from a different
9 perspective, about \$18 million is left unpaid as a result of
10 inventory purchases by Canada that will be used as part of
11 this process to allocate sale proceeds and then ultimately
12 disburse out to unsecured creditors.

13 And the allocation that we're looking at is for 10.4 million
14 based upon the net borrowing-based calculation --

15 THE COURT: Uh-huh.

16 MR. COLLINS: -- and the reason for the
17 difference, really, is that Canada did not cash flow. It was
18 negative cash flow. So, the U.S. would send inventory to
19 Canada on the same terms of which the U.S. was buying it. We
20 view the U.S. as kind of the general purchaser of the
21 inventory for the global enterprise, would send, as needed
22 to, the warehouse in Canada and to the stores what Canada
23 needed, and we would wait. The U.S. entities would wait
24 until the Canada had enough money to maybe make a payment
25 back on the intercompany claim.

1 And that is why it has grown over \$18 million and
2 a substantial majority of it is past due. So, we were
3 comfortable that the Canadian entity and its value certainly
4 benefited and derived from access, indirectly, from the DIP
5 facility, although it is a primary borrower, it's just the
6 borrower that actually made the borrowings was the U.S. and
7 then did the intercompany transfers to Canada.

8 THE COURT: Are the other foreign subsidiaries in
9 the same posture as the Canadian company, but for the fact
10 that they are not named borrowers?

11 MR. COLLINS: In that we sent them inventory?

12 THE COURT: You buy the inventory, send it to
13 them, and it's -- and there's an intercompany receivable,
14 unsecured receivable?

15 MR. COLLINS: I believe that's correct.

16 Is that correct, Paul?

17 MR. KOSTUROS: Yes.

18 MR. COLLINS: Yes.

19 THE COURT: Are those numbers in here, in these
20 calculations?

21 MR. COLLINS: No, they weren't part -- because
22 they're not part of the -- they're not obligors on that, we
23 didn't look to their liabilities to say, Okay, what is your
24 portion of it, because you're not liable on that debt.

25 THE COURT: Your allocable share.

1 MR. COLLINS: I also think -- they were -- most of
2 them were current --

3 UNIDENTIFIED: Yeah, I was going to say that.

4 MR. COLLINS: -- on their intercompany. They were
5 at least cash flow neutral in that they were paying back the
6 U.S. regularly as goods were sold. The Canadian operation,
7 which is really primarily just a distribution channel -- we
8 have retail stores and some e-commerce operations -- that
9 forewall [sic] profitability, if that's the right kind of
10 terminology, was negative and, therefore, they could not even
11 pay the inventory that they were receiving.

12 While, again, I would note that all issues of the
13 allocation of the ultimate purchase price, how much Canada
14 gets, how much the United States gets, is all subject to a
15 fulsome process later. We are not predetermining anybody's
16 recovery. We are simply looking at what is the debt that is
17 on these entities and then you would look at it and say,
18 Okay, this is their proceeds allocation. That ultimately
19 will determine the recovery.

20 But what we believe is happening with --

21 THE COURT: Or a deal gets struck, as we just had
22 a deal get struck here.

23 MR. COLLINS: Correct. But you -- it's hard to
24 ask somebody to lend money into a debt structure where you
25 don't know what the capital structure is and that is a gating

1 item or a gating issue here and when we look at all of the
2 objective, potentially objective calculations one could
3 utilize to apportion this debt, this is what we zeroed in on.

4 And nobody could really -- I don't think anybody
5 has, in fact, disputed it as being appropriate. They would
6 just rather not have it be --

7 THE COURT: They'd rather know more information
8 before agreeing to it.

9 MR. COLLINS: They would rather -- it's result-
10 oriented-type analysis. I would really like to know the debt
11 -- I'd really like to know what my sale proceeds are before I
12 agree to what the debt allocation is. We get that. That's
13 not -- we don't think that's -- while it's a desire and a "I
14 would like to have," debt is debt and assets are assets. One
15 does not necessarily have to do with the other, as we have
16 seen in this court for years.

17 So, it's in that, you know, scenario, Your Honor,
18 that we thought this matter should be brought to Your Honor's
19 attention on full notice to move forward.

20 THE COURT: Uh-huh.

21 MR. COLLINS: I sure I have more lien notes, Your
22 Honor, but that is --

23 THE COURT: I'm sure you do and I'm sure I have
24 more questions, but I wanted to make sure, quite frankly,
25 that I'm not missing something in terms of the motivations

1 and what's bringing us here today. And that's why the first
2 question I asked was about the ABL lender and how they're
3 getting compensated if this is wrong.

4 MR. COLLINS: And --

5 THE COURT: And the proceeds don't end up being as
6 much. I assumed they were not taking less than 100 cents on
7 the dollar.

8 MR. COLLINS: No, not at all.

9 And I knew Your Honor would have those concerns.
10 Is this a leverage play?

11 THE COURT: Uh-huh.

12 MR. COLLINS: Is this to, you know, put leverage
13 on Canada because you kind of can right now?

14 THE COURT: Uh-huh.

15 MR. COLLINS: I will tell you that I don't believe
16 that that is the case and I think our testimony bears that
17 out in great detail, I think.

18 And this is a fairly simple issue at the end of
19 the day, but the process, the analysis, the discussions, I
20 think, all go to the good faith nature of our proposal.

21 THE COURT: Okay. I will let the information
22 officer have a chance to say something.

23 MR. COLLINS: Thank you, Your Honor.

24 THE COURT: Thank you.

25 MS. JOHNSON: Good morning, Your Honor. Erica

1 Johnson from Womble Bond Dickinson, on behalf of the
2 information officer. I do rise to introduce Elizabeth Pillon
3 from Stikeman Elliott, who also represents the information
4 officer.

5 I do also want to introduce Adam Sherman and
6 Pritesh Patel of Richter Advisory Group, who is here on
7 behalf of the information officer, as well.

8 THE COURT: Okay. Thank you.

9 MS. PILLON: Good afternoon, Your Honor. Liz
10 Pillon, Stikeman Elliott, for the information officer. Thank
11 you very much for the opportunity to speak before the Court
12 today.

13 I was going to start -- I understood my role was to be first,
14 a preliminarily statement and then I had some arguments.

15 THE COURT: Yes, let's save the arguments, but I
16 want to hear whatever you have preliminary thoughts.

17 MS. PILLON: Okay. Just so it's clear, the only
18 ancillary proceedings, as I understand it, for Rockport, are
19 in Canada.

20 THE COURT: Uh-huh.

21 MS. PILLON: And so by that, by virtue of having
22 started those, the U.S. debtor must believe that there is
23 value in Canada necessary for it to protect it by way of
24 those additional proceedings.

25 The effect or the -- one of the results of having

1 an ancillary proceeding is the Canadian Court likes to have
2 some eyes and ears and that's who we are, the information
3 officer. So -- and this Court has had numerous experiences
4 with the Canadians, either by way of a full CCAA where the
5 court officer is the monitor --

6 THE COURT: Uh-huh.

7 MS. PILLON: -- or in these types of ancillary
8 roles, the information officer. And in that role, we are the
9 eyes and ears of our court in Canada. They will want to know
10 and hear from us -- and they have telegraphed that already to
11 us: We'd like to know what's happening in the U.S. and also,
12 we'd like to understand how that may affect the Canadian
13 creditors versus others. And so, they will want to know that
14 from us.

15 We hope that in addition to being of assistance to
16 our Canadian Court, we can also -- you can look to us as well
17 and see the assistance if you have any questions with respect
18 to what's happening on the Canadian side.

19 When we came into this scene on the petition date,
20 May 14th, to be clear, we came into it and we inherited the
21 corporate structure. We inherited the debt structure that
22 existed between these companies. We inherited the manner in
23 which they had chose -- decisions had been made for
24 financing, security taken, intercompany financing. We're not
25 changing that. We inherited it and we're trying to deal with

1 it.

2 We've tried to learn about this company. We've
3 tried to ask questions and understand the debt structure and
4 also the allocation agreement that's being put before you and
5 ultimately before the Canadian Court so we could understand
6 what factors went into it, what alternatives might have been
7 available and what evidence really should be before this
8 Court and the Canadian Court before the approval they're
9 seeking is made.

10 In this role and with our obligations to the
11 Canadian Court, we felt it was necessary to file an
12 objection. And I can tell you I've been doing this longer
13 than I wish to admit, and even as a monitor, where we had the
14 more fulsome role, I have never filed an objection into the
15 U.S. and as an information officer, I've never filed an
16 objection into the U.S. So, we did it with a lot of
17 consideration and understanding that we may be going beyond
18 the normal role. And we did it because we thought it was
19 necessary for you to hear from us and we thought that it was
20 necessary for the Canadian Court.

21 And so, I just wanted to let you know, you know,
22 this is not something that's normal. It's not every day that
23 we file these objections. So, that's important to keep in
24 context. I would ask you to, please.

25 The noteholders have outlined a number of

1 requirements that they say they need in order to provide the
2 second tranche of the DIP. And we appreciate the U.S.
3 debtors are in a difficult situation because in order to get
4 this financing, they have to find a way to get through these
5 conditions.

6 The requirements that have been made, though, the
7 initial demands or requirements that were put before this
8 Court had two times roll-up. It has encumbering previously
9 unencumbered assets. It had caps on fees. It had a
10 confirmation, with respect to how much the Canadian estate
11 and its creditors were going to be funding, effectively, the
12 noteholders' recovery.

13 Let's call it what it is. The ABL is getting paid
14 off the top. The ABL doesn't care where the money is coming
15 from. The noteholders care where the money is coming from,
16 so they're piggybacking through the ABL. I respect that, but
17 let's call it what it is, though. And so that's what they're
18 doing.

19 The manner in which that that last requirement has
20 evolved in terms of what it looks like and whether it needs
21 to be an allocation of proceeds or debt or when it needs to
22 be determined, so that's been evolving.

23 But it's interesting that each of the other
24 requirements or demands of the noteholders, in order for it
25 to submit and provide that second tranche of the DIP, have

1 now been resolved or addressed or limited, including, what
2 I've heard for the first time today, by the UCC. So, the
3 roll-up is no longer two times the roll-up; it's one time.

4 We're leaving behind -- they're not encumbering
5 all previously unencumbered assets. They're leaving some
6 behind, which will go into this GUC. There's an increase on
7 the cap on the fees.

8 So, at the end of the day, the only condition that
9 seems to still be a fixation of the noteholders and a
10 requirement seems to be the Canadian estate for some reason
11 and that's difficult to understand why that's required and
12 why that's required now. We're not here to stop the DIP.

13 We're not here to say, Put an end to it if this is
14 what is truly, truly what is required. It's difficult to
15 understand how it is when every other requirement, either
16 there's concessions before we even get here or there's deals
17 that have been struck.

18 THE COURT: What do you think is being set in
19 stone today that can't be undone or corrected?

20 MS. PILLON: Well, a couple things. So, I think -
21 - well, you asked a question, with respect to what are we
22 doing. Are we setting the floor? We're setting the floor.

23 So, when the 18.4 percent, which is number based
24 on the borrowing base -- other alternatives could have been
25 put before you, but let's call it 18.4 percent; that number

1 seems to be the base amount of what is the debt -- it seems
2 to be moving a bit -- but that 18.4 percent sets the floor.
3 And we say, Okay, for us to assess whether 18.4 is
4 reasonable, we need to understand what you say you're leaving
5 behind for the rest of the creditors.

6 And, interestingly, UCC's counsel, apparently had
7 the same concerns and had concerns with respect to what are
8 you leaving behind? What kind of reserves? Are we
9 prematurely determining the use of the funds? All ripe
10 concerns. And it happens to have gotten the U.S. debtor's
11 attention in order to get that resolution.

12 So, we also have those concerns and we said, Tell
13 us what you say you're leaving behind. And what I find
14 difficult -- I don't understand why we can't determine that.

15 We have a valuation that's put before you. The
16 borrowing base conclusion that my friends ask you to use as a
17 basis for the allocation agreement, what is that? That's a
18 liquidation valuation by the ABL. That's the ABL saying,
19 What do we think we get if we monetize this collateral?

20 So -- and I'm sorry, I'm going to launch into my -
21 - some more of my submissions there. But that -- what is
22 that? That's the valuation. My friends say it's not okay
23 for the information officer to throw ultimate proceeds before
24 the Court -- premature; let's not deal with that.

25 But I'm just saying to the Court and to the

1 parties, Let's look at what the most current valuation and
2 the most current information is, and based on that, what can
3 you say you're leaving behind for Canada? Because if by
4 asking you to approve this 18.6 means if at the end of the
5 day, what's allocated to Canada is 10 million plus a dollar,
6 well, sorry, Canadian creditors, you're out of luck.

7 I think this Court, my submission would be this
8 Court and the Canadian Court needs to understand the
9 ramifications of that to the Canadian creditors before they
10 say, Yes, 18.6 is reasonable.

11 THE COURT: Well, I can understand why you'd want
12 that in the negotiation, but I guess the question is, I do
13 need that for this to be in a position to determine this
14 issue?

15 MS. PILLON: Well, I think if you're looking at
16 the borrowing base valuations, based on that, I would request
17 why we can't put something before you. But based on that,
18 there are other figures that are already in the record in the
19 information officer's report with respect to what other
20 values are out there in terms of what we think already -- or
21 continues to exist in Canada.

22 And the alarm bells are going off if we think, for
23 example, in February, 2018, there was Canadian \$24 million in
24 inventory that was sitting in the Canadian estate. How do I
25 get to, on their numbers, 18.6 percent? So, \$10 million

1 coming off the top? Why can't I say that there's something
2 left behind for the Canadian estate from the \$24 million or
3 its current values to be left behind?

4 THE COURT: Obviously, the creditors' committee
5 and the noteholders had some intense negotiations over their
6 positions and came to a resolution, as the information
7 officer had the opportunity to have discussions directly with
8 noteholders to see if a resolution could be fashioned.

9 MS. PILLON: Stop me from going too far here, but
10 a proposal has been made and I believe my friends have been
11 probably busy chatting with each other, as opposed to with
12 the information officer --

13 THE COURT: So, you haven't had a direct
14 discussion?

15 MS. PILLON: We have had some, but, yes, it seems
16 that the more intense discussions were with the UCC.

17 THE COURT: Have been elsewhere. Yeah, I don't
18 want to know the details, but that's fine.

19 MS. PILLON: Right.

20 THE COURT: Okay.

21 MS. PILLON: I guess one last -- may I leave one
22 last point?

23 THE COURT: Uh-huh.

24 MS. PILLON: When my friends say -- when I started
25 this saying we inherited the debt structure, let's keep in

1 mind what everybody was looking to Canada to before we
2 started this. The ABL, although we're a joint borrower, had
3 reduced the availability for the Canadians to zero. I don't
4 know why, but it was reduced to zero.

5 So, as a co-borrower, the Canadians didn't have a
6 right to borrow. We're a guarantor, but they didn't have a
7 right to borrow. How that factors into what -- how they
8 looked at the borrowing-base calculations, I don't know. I
9 don't know Mr. Kosturos knows, but the ABL would. But why it
10 went to zero is potentially an important factor.

11 But what that tells you is they weren't looking to
12 the Canadian assets, the ABL in that sense. The DIP, for the
13 ABL, is not -- we're not a borrower -- Canada is not -- and
14 they're not entitled to receive any benefit from the DIP.

15 And let's look at, more importantly, what the
16 noteholders --

17 THE COURT: So, you will not receive any of the 20
18 million new money?

19 MS. PILLON: Right.

20 THE COURT: Or at least, not directly.

21 MS. PILLON: That's --

22 THE COURT: You can't draw on it directly on the
23 pre -- on the noteholders, you can -- can you benefit from
24 the ABL?

25 MS. PILLON: Neither. So, the DIP ABL -- sorry,

1 ABL DIP, we're not a borrower to. We're not the beneficiary
2 of. We're not entitled to it.

3 That zero-borrowing capability that was in the ABL
4 continues in the DIP ABL. So, we're not getting anything
5 directly from that.

6 We have ring-fenced -- to be clear, we have ring-
7 fenced the money that we do have in Canada. There's no more
8 sweeps coming down to the U.S., and so in this sense, we're
9 able to continue our own operations in Canada with cash on
10 hand. Then the noteholders' new money, whatever it ends up
11 being, we're not a borrower.

12 So, when the noteholders say, Well, it's fair to
13 look at what we looked to Canada for, well, what did they
14 look to Canada beforehand? They didn't take security when
15 think first came in, in 2015. I don't know why, but they
16 chose not to. There's three amendments to the notes. They
17 never took security in Canada. They have a DIP for the
18 notes. They're not seeking to put security over Canada
19 directly.

20 What does that tell you, what the value they
21 suggest is coming direct from Canada? They didn't put --
22 they didn't have expectations before we filed and so it's
23 difficult to understand why they're expectations now are
24 driving, potentially, an adverse effect on the Canadian
25 creditors.

1 The intercompany amount is also important to keep
2 in mind and you touched on this with one of the questions to
3 Mr. Collins. So, in the intercompany, keep in mind -- so the
4 borrowers of The Rockport Group chose how they were going to
5 be financing its Canada subsidiary.

6 THE COURT: Uh-huh.

7 MS. PILLON: They had an ability to take it
8 straight -- well, before the (indiscernible) went to zero,
9 they had an ability to take it from the ABL -- they didn't --
10 so they borrowed -- Rockport U.S. borrowed under the ABL and
11 it came through intercompany. They could have secured that
12 intercompany. They didn't. It came through intercompany
13 unsecured financing.

14 But it's not as if the U.S. estate is going to see
15 zero from Canada. They will see recovery in respect to
16 financings provided when the -- when their share of the
17 intercompany financing claims comes back. So, it's not a
18 zero recovery. We're not saying, Hey, you're going to have
19 to wait. You're going to get zero from Canada.

20 We understand they financed the Canadian estate.
21 And they're going to be recovering it in the same way in
22 which they financed it, intercompany.

23 THE COURT: What are the claims against the
24 Canadian estate, do you have an aggregate -- a sense of the
25 aggregate amount of claims against the Canadian debtors?

1 MS. PILLON: We have categories. So, because
2 right now I don't think we have a number, but we have
3 landlords would be the significant claim. Employee severance
4 claims may be significant, unsecured, anyway -- both of
5 those. And there may be some tax claims, but those would be
6 your buckets: Intercompany and some trade, but it seems like
7 everything was coming primarily through the U.S., anyway, so
8 there's a small amount there.

9 THE COURT: Thank you. Are you going to be
10 putting on a witness today?

11 MS. PILLON: We have the information officer here
12 if you wish to hear anything from them, with respect to
13 potential claims or you have our report, which was filed with
14 the Court in Canada, is also attached to our objection and
15 that offers -- that's the manner in which the information
16 officer puts evidence in before its Court, and so you have
17 that available as well, with some information.

18 THE COURT: And, unfortunately, I didn't have a
19 chance to read that. Okay. I'm just trying to get a sense
20 of how the hearing's going today and who plans to put on
21 witnesses.

22 MS. PILLON: They're available if you have any
23 questions for them.

24 THE COURT: Thank you. Mr. Collins, how many
25 witnesses do you plan to put on?

1 Thank you.

2 MS. PILLON: Thank you.

3 MR. COLLINS: Your Honor, we have two witnesses to
4 put on. My understanding is that it would take less than
5 hour, 45 minutes or so, for both witnesses, subject,
6 obviously --

7 THE COURT: On direct.

8 MR. COLLINS: -- to cross. And I -- in many
9 respects, the testimony would bolster most of my argument, so
10 I'm not -- my -- I think my argument at the end might be
11 pretty short because so much of the detail of our
12 justifications will be going through the witnesses.

13 If I could just try the Court's patience, I wanted
14 to correct, at least in our view, some of the statements made
15 by Ms. Pillon in respect to why looking at Canada now. The
16 fact of the matter is Canada is a borrower under the ABL
17 facilities, jointly and severally liable, for the full \$57
18 million.

19 THE COURT: Uh-huh.

20 MR. COLLINS: They clearly benefitted from the ABL
21 borrowings because, as we've noted, both in the first-day
22 affidavit and elsewhere, Canada has no corporate office.
23 It's all housed -- all of the backroom office and management,
24 human resources, tax, accounting is all done in the United
25 States. The -- and all of those -- the ABL funds were used

1 as -- obviously, as part -- to fund the enterprise. Canada
2 could not operate without the corporate headquarters in
3 Canada. And they clearly could not have operated without the
4 U.S. borrowing monies off the ABL to send over to Canada --
5 in her words -- "\$20 million of inventory," and not pay for
6 it. So the testimony will be clear on that point.

7 I think there's also a misconception. We're not
8 seeking to allocate noteholder debt to Canada. We know
9 Canada is ring-fenced from the noteholder debt and the DIP.
10 We made very clear, we thought about should Canada be a
11 borrower on the noteholder DIP here, and we later on said,
12 no, we're not going to go there, they are ring-fenced, and
13 let's leave it at that, to make sure that there's no issues
14 there.

15 All we are doing is talking about allocating the
16 preexisting ABL debt that Canada is entirely liable for.
17 They entered into the credit agreement back in 2015. I'm not
18 certain we all know why, instead of doing direct borrowings,
19 which they -- which they've recently set up to do, that we
20 stopped, and it just went to the U.S. borrowing it and then
21 doing it. I assume it's for efficiency purposes, rather than
22 having ordering go through one channel, and then bringing it
23 in, and then sending it off to the various enterprises,
24 including the foreign subsidiaries, but that is what it is.

25 So I want to be clear, we're not seeking to foist

1 onto the Canadian assets the noteholder debt here. This is
2 simply to allocate preexisting ABL debt that was there on the
3 petition date.

4 MR. INDYKE: May I be heard, Your Honor?

5 THE COURT: Briefly.

6 MR. INDYKE: Briefly. This is not argument, just
7 a couple of notes.

8 That -- we -- as Mr. Collins stated before, we're
9 fiduciaries, the committee is fiduciaries for the Canadian
10 creditors and the U.S. creditors. In fact, two of the three
11 members of our committee have debt in both Canada and the
12 United States. So we're looking at this carefully. We don't
13 think, certainly on our end, that we're prepared to negotiate
14 some final deal today with the IO about what happens; we
15 think that's what a plan is about. We're not doing the plan
16 today.

17 THE COURT: Well, you negotiated some deal today.

18 MR. INDYKE: But it's to set aside money that
19 otherwise -- if we had -- if we didn't negotiate this deal
20 and had prosecuted our objection, and if we had lost on the
21 roll-up, on the marshaling, on 506(c), on equities of the
22 case, we have nothing to distribute to the creditors. We'd
23 be doing a tremendous disservice to the unsecured creditors
24 in the United States and other creditors, priority creditors
25 that were previously unsecured creditors. But also, I would

1 say to the Canadian creditors, as well, because it's likely
2 that they're going to participate in the recoveries that we
3 get here in the United States case.

4 But we just can't -- the IO has never reached out
5 to us in this case to discuss anything. I mean, we're -- we
6 understood that this was just a battle on allocation for the
7 ABL. There's been no discussion with us. And we don't want
8 to see this fall apart today, go forward, and then, all of a
9 sudden, we're just totally wiped out. So we think that we've
10 cut a deal that the IO should actually support, with further
11 negotiations to continue, with the financing in place, in the
12 context of the sale process and negotiation of a plan. Thank
13 you.

14 THE COURT: Thank you.

15 MS. TO: Your Honor, I'd like to add a few points
16 to the presentations.

17 Ms. Pillon asked why the noteholders are so
18 focused on Canada now. I think the answer is obvious. We
19 are asked, and we have provided funding for the sale process,
20 making an additional twenty-million-dollar commitment, ten of
21 which has been advanced to date, to complete the run and
22 complete the sale process.

23 It was a critical term, from day one, for the
24 noteholders to understand what portion the Canadian debtor
25 would bear of the ABL debt. And the math is pretty simple.

1 If you take \$10 million as the allocated share of the ABL to
2 Canada, and you compare that to a twenty-million-dollar DIP,
3 it's a significant portion of the DIP.

4 I think, to understand the situation -- I mean,
5 this is a condition of the noteholders' commitment. If the
6 Canadian assets were sold now, today, before the Charles Bank
7 transaction closes, I am certain that our friends, the ABL
8 lenders, would be taking every dollar of those proceeds to
9 repay them, themselves.

10 THE COURT: And wouldn't you have a marshaling
11 argument?

12 MS. TO: At that point, they have a first lien on
13 those assets, as Mr. Collins explained. The Canadian debtor
14 is jointly and severally liable for the --

15 THE COURT: And wouldn't you have a marshaling
16 argument, or am I wrong?

17 MR. COLLINS: It might be a contribution argument.

18 THE COURT: No. A marshaling argument between the
19 two of you, with respect to the fact that you say, no, you
20 need to look to other assets first.

21 MS. TO: So, Your Honor, we understand that the
22 privilege of having a secured lien on an asset is that one
23 can be repaid from the proceeds when they are realized. In
24 this case, we have Canadian assets or Canadian collateral and
25 U.S. collateral that's being sold at the same time. We

1 believe -- and this is -- we think that would be an
2 inequitable result, and also is not the condition of our
3 commitment to fund -- that, if all the U.S. assets were used
4 -- or U.S. proceeds were used first to repay the ABL debt,
5 that would effectively create a windfall for the Canadian
6 estate. We don't think that's a fair result.

7 What the noteholders' position has been, from day
8 one, is that they wanted assurances that the Canadian debtor
9 would be bearing its fair share of the ABL debt, not paying
10 it all first, just its fair share, and such that the
11 noteholders are lending into this process, are funding the
12 process, understanding what the ultimate recovery will be.
13 As Mr. Collins explained, this really affects the ultimate
14 recovery of the noteholders; it's a ten-million-dollar issue,
15 more or less.

16 And so the reason we're focused on it is because
17 it's -- it matters, it really affects the bottom line. And
18 we have made the allocation, this allocation issue, a
19 condition to the commitment. We are not prejudging what it
20 is. We want a fair allocation. Mr. Collins explained the
21 allocation the debtors have supported, the UCC has supported.
22 There were allocations that were actually more favorable,
23 ultimately, to the noteholders, but we understand it has to
24 be a reasonable outcome.

25 THE COURT: But why is this -- I guess, other than

1 the fact that you're making it a condition to the DIP
2 financing, why is this an issue for the Court, and not just
3 an intercreditor issue between you and the ABL lenders?

4 MS. TO: It is an intercreditor issue, you are
5 correct. It is an issue for the Court because it is tied to
6 the financing that is in front of you, and that is necessary
7 for these cases to proceed.

8 THE COURT: But if you had a commitment from the
9 ABL lenders that this was going to be the allocation, why do
10 I need to bless it?

11 MS. TO: Your Honor, I think the ABL is agnostic
12 on this issue, and I understand. They will get paid, no
13 matter what, on the -- at the closing of the sale. We
14 believed it was more appropriate for this issue to be in
15 front of you because it ultimately affects the recoveries of
16 creditors. As we can see, there are some strong views on
17 this issue. I think that's why the issue is in front of you.
18 But the proposed allocation that's been presented and
19 accepted by two fiduciaries here, and supported by the
20 noteholders, is, we believe, a fair allocation.

21 THE COURT: Let me ask you the same question I
22 asked somebody else. What's being baked into this today that
23 I can't undo? What is the consequence, the logical
24 consequence, of approving this today? What other effect does
25 it have on -- I mean, you say there's no allocation --

1 there's no effect, or I've heard there's no effect on asset
2 allocation. But don't people have in their minds what is
3 happening today when they look at the proceeds that come in?
4 What is being baked in today to this decision?

5 MS. TO: My understanding of what's being agreed
6 to today is that, to the extent that there are -- we know
7 that there are proceeds -- Canadian assets being sold to
8 Charles Bank. The question is: What is the value allocated
9 to them? It might be more than the \$10 million or so that we
10 are asking you to approve today; it might be less. It might
11 be just 10 million.

12 If it's 10 million, the result of the agreement
13 today is that the 10 million would go to the ABL, minus what
14 is necessary to pay the administrative costs, the charge in
15 Canada. That's the agreement today. If the proceeds are
16 determined to be more than 10 million, then the 10 million --
17 using that as a round number --

18 THE COURT: Uh-huh.

19 MS. TO: -- the 10 million goes to the ABL, the
20 balance would go to pay the administrative costs in Canada.
21 And if there is an excess, that would be distributed among
22 creditors. But it is possible -- depending on what the
23 ultimate valuation of the Canadian assets is, it's possible
24 that there would be nothing left, mathematically, after the
25 ABL is paid, and the administrative charge.

1 The only thing I would add, which is very
2 important, as you heard, we have reached a settlement with
3 the official unsecured creditors' committee, which we would
4 expect would benefit all unsecured creditors. And so it's
5 not true to say there would be nothing. There might be
6 nothing from the excess collateral proceeds in Canada,
7 depending on what the ultimate valuation is.

8 (Pause in proceedings)

9 THE COURT: We're going to go forward with the
10 hearing, and I want to hear the evidence. It just strikes me
11 that, absent this unusual request, this is a premature
12 determination, and it's something that would be negotiated as
13 part of an entire resolution of a case, and what we're doing
14 is we're taking one piece out of that.

15 And it may be necessary here to do that because of
16 the request that's being made by the noteholders, but that's
17 why I've asked the question that I've asked twice now, is:
18 What am I really doing here, and how does it impact the rest
19 of the case, and how it gets resolved ultimately?

20 MR. COLLINS: If I could just add to that, Your
21 Honor.

22 THE COURT: Uh-huh.

23 MR. COLLINS: How I look at this is we are
24 identifying, in essence, the capital structure of Canada. We
25 are saying, first will be paid the administrative charge;

1 second will be paid the ABL apportioned debt; third,
2 everything else goes to Canada -- I'm sorry -- to the
3 Canadian creditors, of which the intercompany is part of.

4 THE COURT: Uh-huh.

5 MR. COLLINS: That is what we're setting today.
6 That -- it's no different than coming into court on any other
7 debtor and saying, we believe the amount of the secured debt
8 is \$65 million, this is the second lien debt of \$100 million.
9 Assuming that debt is valid, that has to get paid in full
10 before anything else goes down. That's what we're doing here
11 today. We're simply apportioning the ABL debt of what the
12 Canadian hurdle is of the proceeds of sale for recoveries to
13 unsecured creditors.

14 THE COURT: Thank you.

15 We're going to take lunch before we start. And I
16 would also encourage, during lunch, for people to talk. I
17 don't know that there's much that can be done, but I always
18 encourage people to talk during lunch. We'll be back at two
19 o'clock, and we'll take our witnesses.

20 MR. COLLINS: All right. Thank you, Your Honor.

21 THE COURT: Thank you very much. We're in recess.

22 (Luncheon recess taken at 1:01 p.m.)

23 THE COURT: Please be seated.

24 Mr. Collins.

25 MR. COLLINS: Yes. Good afternoon, Your Honor.

1 Thank you for the lunch break. That certainly was
2 helpful just to be able to sit down and talk a little bit.
3 Unfortunately, we don't have resolution of the issue before
4 Your Honor today. So, we would like to move forward.

5 So, unless Your Honor has any follow-up questions
6 I will turn the podium over to my colleague, Mr. Kandestin,
7 for the presentation of our witnesses.

8 THE COURT: I don't have any follow-up questions.
9 I did take advantage of the break and read the report of the
10 information officer and the orders entered by the Canadian
11 Court. So, it helped me as well.

12 MR. COLLINS: Okay. Thank you, Your Honor.

13 MR. KANDESTIN: May I please the court, Cory
14 Kandestin for the debtors.

15 Your Honor, before we call our witness, may I
16 approach the bench with a copy of the exhibit binder?

17 THE COURT: Yes.

18 MR. KANDESTIN: The debtors call Paul Kosturos to
19 the stand.

20 PAUL KOSTUROS, WITNESS, SWORN

21 THE CLERK: Would you please state your full name
22 and spell your last name for the record.

23 THE WITNESS: Paul Kosturos, K-O-S-T-U-R-O-S.

24 THE CLERK: Thank you. You may be seated.

25 MR. KANDESTIN: May I proceed?

1 THE COURT: Yes.

2 DIRECT EXAMINATION

3 BY MR. KANDESTIN:

4 Q Good afternoon, Mr. Kosturos.

5 A Hi.

6 Q By whom are you employed?

7 A I'm a senior director with Alvarez & Marsal. I am also
8 the interim chief financial officer of the Rockport Company.

9 Q What does your practice at Alvarez & Marsal focus on?

10 A I am part of the private equity operations group. We
11 specialize in dealing with private equities, mergers,
12 acquisitions, carve-outs, performance improvements; I
13 personally specialize in interim CFO work.

14 Q You mentioned that you are the interim CFO of the
15 debtors, is that correct?

16 A That's correct.

17 Q How long have you held that position?

18 A Since August 1st, 2017.

19 Q And, briefly, what are your duties and responsibilities
20 as interim CFO?

21 A I oversee all finance and accounting activities, along
22 with human resources and legal as well.

23 Q In your capacity as interim CFO are you familiar with
24 the debtors' financial affairs and operations?

25 A Yes, I am.

1 Q And does your knowledge include the debtors' recent
2 efforts to secure post-petition financing?

3 A Yes, it does.

4 Q Can you please turn to Tab 1 of the exhibit binder?
5 You'll see an exhibit pre-marked E-1. Are you familiar with
6 this document?

7 A Yes, I am.

8 Q What is it?

9 A This is the revolving credit agreement between Rockport
10 and Citizen's. We basically call this the ABL agreement.

11 Q And for purposes of testimony today is it okay if refer
12 to this as the ABL facility or the ABL agreement?

13 A Yes.

14 Q Have you referred to this agreement over the course of
15 your duties as interim CFO?

16 A Many times including certifying on a monthly basis that
17 the financial statements are in agreement with this document.

18 Q I know this is a long document, but does the document
19 before you appear to be a true and correct copy of the ABL
20 facility agreement?

21 A Yes, it does.

22 Q Can you generally describe what the ABL facility is?

23 A This provides Rockport with the funding necessary to
24 complete their day to day operations.

25 Q And who are the borrowers under the ABL facility?

1 A The Rockport Group, the Rockport Company which is the
2 operating company and Rockport Canada.

3 Q So, those three entities?

4 A That's right.

5 Q Were there guarantors of the facility?

6 A Yes, the Rockport Group, the Rockport Company and
7 Rockport Canada.

8 Q And with the exception of Rockport Canada or perhaps
9 its parents, are any foreign entities other than Canada
10 parties to the ABL facility?

11 A No, they are not.

12 Q And with the exception of Rockport Canada or its parent
13 have any foreign or Rockport entities pledged assets to
14 secure the ABL facility?

15 A No, they have not.

16 Q Did the borrowers pledge assets to secure the facility?

17 A Yes, they did.

18 Q Generally speaking, what types of assets did the
19 borrowers pledge?

20 A Generally, it's the accounts receivable and inventory
21 of each entity.

22 Q Does the ABL facility divide liability among the three
23 borrowers?

24 A No, they do not.

25 Q So, how does it deal with liability?

1 A They're both jointly responsible for all of the ABL
2 agreements.

3 Q And by both you're referring to Canada and the US?

4 A Canada and the US, yes.

5 Q I'd like to ask you about how the debtors use the funds
6 that they drew from the ABL facility.

7 Did each of the three borrowers draw directly or was
8 there one debtor that drew?

9 A No. Only the Rockport Company. The operating company
10 is drawing funds on the ABL.

11 Q So, by the Rockport Company you're referring to the
12 Rockport Company, LLC?

13 A That's correct.

14 Q And for short-hand is it okay if I refer to that just
15 as Rockport?

16 A Sure.

17 Q Generally speaking, how did Rockport use the funds that
18 it drew under the ABL facility?

19 A We used the funds for day to day operations.

20 Q Does that include purchasing inventory?

21 A Yes, it does.

22 Q Did Rockport Canada draw on the ABL facility?

23 A No.

24 Q If Rockport Canada wasn't directly drawing on the ABL
25 facility how did Rockport Canada procure inventory?

1 A Rockport Canada buys the inventory from Rockport
2 Company, the US company. The US company buys inventory for
3 all of our foreign assets and foreign entities. We pay
4 through that and then we intercompany and sell those to the
5 foreign entities.

6 Q What type of pricing does Rockport sell inventory to
7 its subsidiaries?

8 A We use landed costs plus 8.25 percent for the foreign
9 entities.

10 Q So, for the laymen in the room what does cost mean?

11 A The full cost that we pay the factories for the goods.

12 Q Okay. And the 8.25 percent that you mentioned, what
13 does that consist of?

14 A Since none of the foreign entities have any product
15 groups or sourcing groups this represents the US entities
16 product and sourcing groups. Product are the ones that are
17 designing all of the shoes, working through them and
18 everything. The sourcing group helps procure it, works with
19 the manufacturer for quality and things like that.

20 Q When Rockport received money and payment for this
21 inventory from Rockport Canada what would happen to that
22 money?

23 A That money would come into the US and then currently
24 under the ABL agreement all receipts coming in are swept on a
25 daily basis to cover the ABL.

1 Q Were funds from the ABL facility needed to get
2 inventory to Rockport Canada?

3 A Yes.

4 Q Did Rockport Canada have the cash to do that on its
5 own?

6 A No.

7 Q Did Rockport Canada have the cash to operate without
8 the debtors drawing on the ABL facility?

9 A No. Rockport Canada loses cash.

10 Q Does Rockport Canada have its own back-office
11 operations?

12 A No. They have no back-office. The only thing they
13 have are a few sales people and one small sew room.
14 Everything else is done by the US entity including treasury,
15 accounting, finance, HR; all back-office support is done by
16 the US company.

17 Q How about management of the company, where is that
18 located?

19 A It's all at our headquarters in the US.

20 Q Who pays the salaries and expenses of the people
21 providing those corporate services?

22 A The US company.

23 Q What is the source of the funds that the US company
24 uses to pay those salaries?

25 A It comes from the daily operations on the ABL.

1 Q Now you mentioned a little earlier that Rockport Canada
2 loses money?

3 A That's correct.

4 Q Can you explain that a little more?

5 A So, for 2017 Rockport Canada, from an EBITDA basis,
6 earns before interest taxes lost \$8 million dollars for 2017.
7 The consolidated company for 2017 lost \$1 million dollars.

8 Q And you mentioned that Rockport sold inventory to
9 Rockport Canada?

10 A That's correct.

11 Q Has Rockport Canada paid for all the inventory that it
12 has received?

13 A No. At the data filing there was an intercompany for
14 about \$18 million dollars of which 80 percent of that was
15 past due, and of that 40 percent of that amount was past due
16 over 120 days.

17 Q So, what does that past due nature tell you about the -
18 - tell you about Rockport Canada's operations?

19 A They don't have the cash-flow to pay us -- to pay the
20 Rockport Company on an ongoing basis.

21 Q Okay. Let's turn to the allocation that the debtors
22 are proposing.

23 Can you briefly explain what it would mean to allocate
24 the ABL debt?

25 A Well, what it's trying to do is be fair and, basically,

1 allocate the debt between the two companies because they're
2 both jointly liable for the ABL.

3 Q So, when you say the two companies to which entities
4 are the debtors proposing to allocate the debt?

5 A To the US companies and to Canada.

6 Q Do the debtors propose to allocate debt to any of their
7 foreign entities other than Rockport Canada?

8 A No.

9 Q Why not?

10 A They're not part of the agreement.

11 Q Under the DIP credit agreement are the DIP noteholders
12 -- DIP note-lenders making new money available to the
13 debtors?

14 A Yes, they are; a total of \$20 million dollars.

15 Q And does the DIP credit agreement contain any
16 provisions about allocating the ABL debt?

17 A Yes, it does. It's a requirement.

18 Q Is it important for the debtors to get final approval
19 of the DIP today?

20 A It is very important to get the agreement.

21 Q Can you explain why?

22 A Well, you know, for one thing it's part of the ABL
23 agreement, but more than that we've made agreements with all
24 of our factories to keep goods flowing in. There were some
25 at the beginning that were starting to rumble about

1 potentially not sending us the goods on time. So, we have
2 agreements with them to continue shipping on time. Part of
3 that was because the ABL and we had enough funding to
4 continually pay them. So, we are paying all of their
5 prepetition notice through critical vendors and foreigners.

6 If it comes to be that the DIP is not approved I am
7 concerned that the factories could see that as a sign of
8 weakness and potentially start trying to re-negotiate deals
9 with us.

10 Q Could you turn to Tab 2 of your exhibit binder, please?
11 It's a document pre-marked as Exhibit D-2. Are you familiar
12 with that document?

13 A Yes, I am.

14 Q Can you identify what Exhibit D-2 is?

15 A This is the borrowing base certificate for the Rockport
16 Group as of April 15th, 2018.

17 Q 2018?

18 A Mm hmm.

19 Q Are you familiar with this document in the course of
20 your employment as interim CFO?

21 A Yes, I am. We're required to file this every 15 days
22 with the ABL holders.

23 Q And do you intend to see this document before it is
24 approved? What is your role in this document?

25 A I see this document before it's approved. I get final

1 approval for it. It's created by our treasurer and are
2 corporate controller, but nothing gets filed until I see it
3 and I give approval for it.

4 Q Do the debtors prepare this document regularly?

5 A Yes. Every 15 days is now required.

6 Q Is it the regular course of business for the debtors to
7 prepare borrowing base certificates for the ABL facility?

8 A Yes.

9 Q Timing wise when the debtors prepare a borrowing base
10 certificate for a given period do they prepare the
11 certificate within 15 days of that period?

12 A They do.

13 Q So, what is the ultimate purpose of a borrowing base
14 certificate?

15 A This sets the maximum that we can borrow under the ABL
16 agreement even though the ABL agreement allows us to borrow
17 up to \$60 million dollars. If we do not have the borrowing
18 base to support a \$60 million-dollar availability this sets
19 the tone of what we can borrow to.

20 Q So, how does it do that? How does this set the amount
21 you can borrow?

22 A Well, there's two main items of the borrowing base; one
23 is the accounts receivable and, one, is based on the
24 inventory. It starts with the gross amount of inventory
25 and/or gross amount of accounts receivable that we have at

1 the time of filing. It then subtracts different in-eligible
2 per the agreement or different types of reserves associated
3 with it. Then it calculates a net eligible inventory; that
4 then is then subject to an advance rate that is not 100
5 percent. The ABL then reduces it and then they also take for
6 the inventory a net orderly liquidation value percentage of
7 it. It basically sets the floor if we add those together and
8 then that determines our full borrowing base available.

9 Q So, what is the net value of the inventory represent --
10 excuse me, the net value of the collateral represent?

11 A It is an estimation of what it would be from a
12 liquidation standpoint of the ABL needed to liquidate the
13 inventory.

14 Q Can you explain the method by which the debtors, today,
15 are proposing to allocate the ABL debt?

16 A We are basing the allocation on the borrowing base
17 through the difference between the US, what the US has and
18 the Canadian company has.

19 Q And what does that proportion work out to be?

20 A 18 -- I believe its 18 percent.

21 Q Why do the debtors believe that method is appropriate
22 for allocating the ABL debt?

23 A Well, the borrowing base is what's really used to set
24 what we can borrow to. It's really the only thing that sets
25 what we're able to borrow to. We are allowed to borrow both

1 on the US and Canadian on a consolidated basis.

2 Q Why do the debtors use the net amount of the borrowing
3 base as opposed to, day, the gross amount?

4 A Net is ultimately what we're allowed to borrow on where
5 the gross is not.

6 Q Can you please turn to Tab 3 of your exhibit binder?
7 Before you is an Exhibit marked D-3. It was also attached as
8 Exhibit D to the DIP motion and Exhibit 3 to the reply in
9 support of the DIP motion.

10 Can you turn the page to the charts? Are you familiar
11 with this document?

12 A Yes, I am.

13 Q What is it?

14 A This is the allocation that we proposed for the
15 allocation and debt. It's basically just a summary of
16 everything that's on the borrowing base that we just went
17 over on Exhibit 2. It just breaks down between US Canada,
18 the total and then how much of it is apportioned to Canada.

19 Q So, the numbers here come from the borrowing base
20 certificates?

21 A Yes, they do.

22 Q And you'll see there are a number of rows. Can you
23 just briefly walk us through those rows?

24 A This, again, starts with accounts receivable up in item
25 number B. This starts with the gross amount and then as

1 we've talked about it takes out some of the adjustments to
2 get to the net amount. Then it does the same thing for the
3 inventory amounts. Then you can see the other reserves that
4 are included. Getting down to the net consolidated value --
5 collateral value for both the United States and Canada.

6 Q And what are those adjustments that your referring to
7 again?

8 A These are different types of in-eligible that the bank
9 doesn't allow us to borrow on or other types of reserves.

10 Q And you'll see towards the bottom of the charts there's
11 a row called total collateral value, do you see where I am?

12 A That's right.

13 Q Can you walk us through that row?

14 A So, the US shows that the total collateral value for
15 the accounts receivable of inventory based on the borrowing
16 base is \$50.5 million dollars and Canada is 11.4. So, the
17 total is almost \$62 million dollars. The last column 18.4
18 represents the portion associated with Canada.

19 Q So, the \$11 million-dollar figure is 18.4 percent of
20 the total \$61 million-dollar figure?

21 A That's right.

22 Q Let me ask you about the row at the very bottom of
23 Exhibit D-3, its entitled ABL revolver balance allocation.
24 Do you see where I am?

25 A Yes.

1 Q You'll see the ABL revolver balance is listed as 53.45
2 million. Has that number changed at all?

3 A Currently it changes on a daily basis.

4 Q Why is that?

5 A Per the ABL agreement that was modified in November the
6 ABL now sweeps the US cash that comes in. So, all receipts
7 that come in modifies that balance on a daily basis. Then
8 we're in, what's called, cash dominion. So, they're sweeping
9 everything and then as we need to make payments we have to
10 then draw back down on the ABL. So, it changes on a daily
11 basis.

12 Q My question was a little bit different. As of the
13 petition date -- let me refer you to note one that is on the
14 bottom of Exhibit D-3. Can you please explain that note?

15 A So, that is the balance that the ABL is outstanding at
16 the time \$53.4 million dollars, but at the same time we also
17 have two LC's out there for \$3.55 million dollars. We
18 consider that part of the ABL balance because we're not
19 allowed to borrow on those two amounts combined. Recently
20 what the draw-down for \$2.5 million dollars immediately went
21 to the line of credit anyway.

22 Q So, has that letter of credit been drawn?

23 A One of them has.

24 Q And for how much was that?

25 A \$2.5 million dollars.

1 Q And that letter of credit is supported by the ABL
2 assets?

3 A yes. They immediately -- when the ABL just took the
4 money right from our accounts to fund that amount of money.

5 Q Can you turn to Tab 4 of the exhibit binder, please?

6 And for the record this is a copy of the information
7 officer's objection that was filed at docket number 165.

8 And I'll refer you to Page 16 of that objection. Let
9 me know when you're there?

10 A Okay.

11 Q And you'll see towards the top of Page 16 of the
12 objection, Subparagraph (d). I'd like to ask you about that
13 paragraph, but before I do I'd like to read part of the first
14 sentence in for context. The first sentence reads:

15 "There are alternative methods that could have been
16 used by the debtors and DIP note agents to frame the
17 initial allocation of debt such as."

18 Then it lists four proposed methods. I'd like to
19 ask you about those four methods.

20 So, starting with the first method, which is allocation
21 based on the actual manner in which financing was provided to
22 the Canadian estate. You mentioned earlier that it was only
23 Rockport that directly drew from the ABL facility, right?

24 A That's correct.

25 Q Did the debtors believe that allocating ABL debt based

1 on the various debtors direct drawing from the facility was a
2 fair method?

3 A No. We don't consider that fair since Canadian -- the
4 company is definitely losing money from the ABL to fund the
5 operations?

6 Q And how about the second proposed method in Paragraph
7 37(d) which is a comparison of the Canadian estate's revenue
8 versus global revenues. Did the debtors consider a
9 comparison of the Canadian estates revenues against global
10 revenues to be a reasonable method to allocate the ABL debt?

11 A No. We didn't think it was reasonable because, again,
12 the foreign companies are part of the ABL agreement. So, it
13 didn't make sense to us to include it based on global revenue
14 when they weren't part of the agreement to begin with.

15 Q Has any foreign company other than Canada pledged
16 assets to secure the ABL facility?

17 A No.

18 Q Let's take a look at the third proposed method in
19 Paragraph 37(d), estimated liquidation valuations. How does
20 that method compare to the borrowing base approach that the
21 debtors are proposing?

22 A That's basically the same.

23 Q How so?

24 A The borrowing base is trying to get to the liquidation
25 values that the ABL could get to if they needed to liquidate

1 it. So, it's reasonably close.

2 Q Let's take a look at the final proposed method in
3 Paragraph 37(d) which is Canadian assets versus global
4 assets. Did the debtors consider that to be a reasonable
5 method to allocate the ABL debt?

6 A We see this as the same as using the revenue as well
7 since the global assets aren't part of the ABL. We don't see
8 why that would be a reasonable way of doing it.

9 Q To allocate the ABL debt do the debtors believe that it
10 is necessary to know in advance the amount of sale proceeds
11 that will come into any particular debtor?

12 A No, because the balance is known at the date of filing.

13 Q The balance of?

14 A Of the ABL.

15 Q Do the debtors believe that it was necessary to know in
16 advance the size of unsecured claims at any particular entity
17 to fix the secured claims?

18 A No. Again, that doesn't really relate to the size of
19 the ABL balance at the date of petition.

20 Q Is there some other debt allocation method that the
21 debtors are aware of that they believe is more reasonable
22 than the one that they are proposing today?

23 A We are not aware of any other way of doing this.

24 MR. KANDESTIN: Your Honor, before I cede the
25 podium I would move into evidence the exhibits under Tabs 1,

1 2 and 3. Tab 1 is the prepetition ABL facility agreements.
2 Tab 2 is the borrowing base certificates. Tab 3 is the
3 summary of the allocation method that was attached as Exhibit
4 D to the DIP motion.

5 THE COURT: Is there any objection?

6 MS. PILLON: I don't object, but -- Liz Pillon for
7 the record. If we're going to be including exhibits you
8 referenced him to Exhibit 4 which is the objection; most
9 importantly the report. So, if we're bringing in the
10 evidence then the evidence in the report can also be brought
11 in. I think there was an understanding before we started
12 that that would be the arrangement.

13 MR. KANDESTIN: We don't object to having the
14 exhibits that were attached to the information officer's
15 objection being admitted into evidence.

16 THE COURT: Okay. So, then Debtors' Exhibits 1, 2
17 and 3 are admitted without objection and the exhibits to the
18 objection reservation of rights of Richter Advisory Group are
19 admitted without objection.

20 (Debtors' Exhibits 1, 2 and 3 admitted)

21 (Richter Advisory Group Objection admitted)

22 MR. KANDESTIN: No further questions for the
23 witness, Your Honor.

24 THE COURT: Thank you.

25 Cross?

1 MS. PILLON: Liz Pillon, Stikemon Elliot, for the
2 information officer for the record.

3 CROSS EXAMINATION

4 BY MS. PILLON:

5 Q Just a few questions, please, Mr. Kosturos.

6 Just to be clear, you've referenced the ABL, Exhibit D-
7 1. To be clear for the record that's the only secured debt
8 of Rockport Canada, correct?

9 A That's correct.

10 Q And the noteholders' prepetition notes are not secured
11 against Rockport Canada, correct?

12 A That's correct.

13 Q And the intercompany financing that Rockport Group
14 provided to Rockport Canada for inventory or other services,
15 again, not on a secured basis, correct?

16 A That's correct.

17 Q On the borrowing base certificate I believe it was
18 Exhibit D-1 -- pardon me, D-3. Can you pull that up?

19 A Okay.

20 Q And you said you were involved in the preparation of
21 the underlying borrowing base certificates and then this
22 document to try to determine a fair allocation, correct?

23 A Yes, I was involved. I didn't prepare it, but I was
24 involved.

25 Q And would you agree with me that a borrowing base

1 certificate is simply another form of a liquidation analysis?

2 I think those, in fact, were your words.

3 A Well, the borrowing base certificate provides much more
4 than that in this case though. The borrowing base
5 certificate sets what we can borrow to.

6 Q Right.

7 A So, although it estimates the liquidated value, but
8 that's agreed upon with no negotiations with the ABL
9 providers.

10 Q Right. And in that sense, in terms of using it as a
11 determination of the value of potential Canadian collateral,
12 would you agree with me it's quite a conservative approach
13 because a borrowing base, by its nature is conservative,
14 fair?

15 A It depends on how you look at it as to what is
16 conservative, but it sets the pace of what we can borrow to.
17 So, that's all we can borrow to; whether it's conservative or
18 not that's all we can borrow to.

19 Q In your experience as a financial advisor all these
20 years and in your experience in the Rockport Group did you
21 think the borrowing base certificate was quite conservative
22 in terms of the adjustments that were being taken to reach
23 the underlying value of the collateral?

24 A Well, I mean if you look at the borrowing base
25 certificate everything that you see is normal course. So,

1 for accounts receivable everything that's aging in all of
2 those reserves that's pretty normal. An advance rate of 85
3 percent on the accounts receivable is pretty standard. The
4 same thing with the inventory, you have all the reserves and
5 what not that's normal course. They always have an advance
6 rate that's less than 100 percent and then they always have
7 some sort of liquidation, net orderly liquidation value, one
8 could argue one way or another. It's always -- this is all
9 standard practice.

10 Q In preparing for today did you take a look at the
11 Rockport Canada most recent balance sheet for Rockport Canada
12 separately?

13 A Most recent -- what period would that be?

14 Q Balance sheet for Rockport Canada.

15 A At what period of time?

16 Q What is the most recent that's available? Would it be
17 May 31st that's available, April 30th?

18 A April 30th is the most recent.

19 Q Okay. And in that balance sheet can you help the court
20 with respect to what valuations were available, were values
21 were attributed to wholesale inventory?

22 A It would have been standard cost.

23 Q Do you have a number?

24 A No, I don't have a number.

25 Q Okay. You don't have a balance sheet here with you?

1 A No. It's not something I walk around with.

2 Q No, that's fine. I thought maybe in preparation for
3 today you brought it with you so the court had an
4 understanding of what the current values are of the
5 collateral before it.

6 In terms of -- if we go back to Exhibit 3 that we just
7 were talking about, the Rockport allocation agreement -- do
8 you have that, sir?

9 A Yes.

10 Q In the column Canada, at the bottom -- and my friend
11 took you to this to ask you a question about total collateral
12 value. So, the estimated total collateral value for Canada
13 is 11,403,000, correct?

14 A Yes.

15 Q And my understanding now, based on your updated ABL
16 figures, is your now at -- if you apply your 18.4 percent
17 allocation my understanding is you are now at \$10,483,480
18 dollars being the 18.4 percent figure of prepetition debt. I
19 get that number, Your Honor, from the revised order that my
20 friend, Mr. Collins, passed up to you.

21 So, sir, we have based on your revised ABL you now are
22 at 10,483,000 that you say would be available under your deal
23 to pay down the ABL, correct?

24 A Okay.

25 Q And based on the total collateral value then of

1 11,403,000 with cost associated and liquidated you are,
2 essentially, nothing behind for the Canadians. Is that the
3 way I am to read this document?

4 A Well, if that's how the numbers work out, but I can't
5 speak to how you're interpreting it because I don't have
6 those numbers in front of me.

7 Q No, these are the numbers I have; we both have them.

8 A The ABL changes every -- the borrowing base changes
9 every 15 minutes.

10 Q Right. So, the value of actually what the proceeds
11 could be we don't know. It would be beneficial if we could
12 wait and know what the actual proceeds are, but as of the
13 numbers that you're putting in front of the court today and
14 asking for approval from what we know we have total
15 collateral value of 11 million 403, do you see that, sir?

16 A Yes.

17 Q And of that you're asking the ABL to be permitted,
18 under your allocation agreement, to take 10,483,000 of that,
19 correct?

20 A Okay.

21 Q Under the post-filing post-petition cash-flows for
22 Rockport Canada, as I understand it Rockport Canada is not a
23 borrower and does not have availability under the ABL DIP,
24 correct? Pardon me, it's a borrower, it doesn't have
25 availability under the ABL DIP.

1 A What do you mean not available? What do you mean
2 availability?

3 Q We're not getting any of the DIP.

4 A Indirectly Canada is, sure, because the US company is
5 buying all the inventory and then selling it. The US company
6 is using that money to pay for it, but indirectly yes.

7 Q Directly?

8 A No.

9 Q And noteholder DIP, the Rockport Canada is not entitled
10 to any of the amounts of the noteholders directly or
11 indirectly, correct?

12 A Not directly, no.

13 Q Okay. And in the post-filing cash-flows for Rockport
14 Canada because of the ring-fencing that's now occurring where
15 money continues to remain in Canada, am I right that Canada
16 is, effectively, self-financing and does not, in fact,
17 require money from either of the DIP's?

18 A That's true because they're not paying for the
19 inventory that's in Canada as of today. So, they're selling
20 inventory that they didn't pay for.

21 Q The US debtors might be doing the same thing, correct?

22 A No.

23 Q Okay.

24 A All prepetition factories we're paying 100 percent for
25 the agreement of the DIP and for this case. So, we're paying

1 for all of that inventory, but we are not collecting -- and I
2 don't want to say we, but from a company perspective the US
3 is not getting paid for Canada for the prepetition amounts
4 that they paid for. So, although Canada is cash-flow
5 positive now it doesn't seem fair that that's how it's
6 working.

7 Q But from the post-petition point of view Canada is not,
8 in fact, required at this point to look to either of the
9 DIP's, including the note DIP, for ongoing operations,
10 correct?

11 A Yes, but, again, because they're not paying for the
12 inventory that they're currently selling.

13 Q Okay. The stalking horse arrangement that's been
14 before this court, as I understand it the Canadian wholesale
15 inventory and accounts receivable are included as a purchased
16 asset, correct?

17 A That's correct.

18 Q And can you help me with the -- is the price that's
19 being paid for that inventory and accounts receivable, is
20 that at cost?

21 A What do you mean the price being paid?

22 Q Purchase price.

23 A I don't know how Charles Bank came up with their
24 purchase price. So, I can't speak to how they're allocating
25 it between the entities.

1 Q And if retail --

2 A I would think, though, since Canada is losing money
3 that there's -- I don't know how they did it, but I would
4 assume they based some profitability or something. Canada is
5 one of the entities that loses money, but I don't know how
6 they did that allocation.

7 Q They're purchasing inventory and accounts receivable,
8 right?

9 A Right, but they did put some sort of value into that as
10 they came up with their purchase price. I'm assuming.
11 Again, I had nothing to do with how they came up with their
12 purchase price.

13 Q One of your earlier declarations, as I understand it,
14 if the retail inventory and the retail stores were being put
15 into the stalking horse it would have been done on the basis
16 of cost of that inventory, correct?

17 A That's correct.

18 Q So, is it a fair assumption that maybe that's the exact
19 same way they're valuing the wholesale inventory that's
20 included in the stalking horse?

21 A I can't answer that question. I don't know.

22 Q If the allocation agreement of 18.4 percent is accepted
23 by the court am I right that therefore the ABL has agreed
24 that it's not looking to anything further from Canada if it
25 receives the 18.4 percent of the prepetition amount?

1 A I can't speak to what the ABL agreed to.

2 Q Well, what do you think is the agreement, sir, that
3 you've put before the court?

4 A The ABL will get 100 percent based on all of the assets
5 of both the US and Canadian companies.

6 Q So, is there a chance we're going above the 18.4
7 percent if, somehow, they didn't earn enough out of the US
8 estate?

9 A They're entitled to 100 percent based on all of the
10 assets of both the US and Canadian companies.

11 Q Do you believe there's a lingering claim into the
12 Canadian estate should this 18.4 percent allocation agreement
13 be approved in respect of the ABL?

14 A I haven't really looked at it from that perspective. I
15 focus, basically, on day to day in keeping this company
16 going. I'm not looking at what it's going to look like in a
17 month from now right now.

18 Q You explained to my friend the manner in which -- and I
19 think it's in your declaration, the manner in which
20 intercompany, the financing for inventory for Rockport Canada
21 would come intercompany. Then as payments were made back the
22 ABL would sweep it and take the funds for the ABL and reduce
23 the ABL, correct?

24 A Essentially, yes.

25 Q And, correspondingly, there would be a reduction in the

1 intercompany amount that was owing because Canada had repaid
2 it via the intercompany financing, correct?

3 A Yes.

4 Q So, if this ABL allocation is accepted and a dollar
5 leaves Canada with respect to ABL satisfying the ABL would
6 you agree with me that it's fair that there's a corresponding
7 reduction in the intercompany claims that came from the
8 Rockport Company?

9 A It's possible, yes. It's reasonable, yes.

10 Q Okay. Last question.

11 Based on -- you had some discussions with my friend
12 about need for the DIP. So, based on the cash-flows that
13 you've seen when do you see the first time that the second
14 tranche of the DIP will be required?

15 A It just depends. We have some assumptions within the
16 DIP for some payments. If we don't have to make those
17 payments the first tranche of the DIP could be pushed out,
18 but at the same time if our receipts aren't coming in at the
19 same level we think it could be earlier.

20 So, it's hard to tell. I believe the original DIP said
21 we were going to be drawing it down next week. We won't be
22 doing that next week, but at the same time it serves as a
23 backstop to show our vendors that we have plenty of liquidity
24 to keep the estate running until the auction.

25 Q So, the earliest date you could be drawing down on the

1 second tranche of the DIP would be drawing down on the second
2 tranche of the DIP would be?

3 A I don't think it's going to be next week. So, it's
4 probably, at least, a week out from that.

5 MS. PILLON: Okay. Thank you very much.

6 THE COURT: Redirect?

7 REDIRECT EXAMINATION

8 BY MR. KANDESTIN:

9 Q Mr. Kosturos, how much money did Canada lose last year?

10 A From just an EBITDA perspective \$8 million dollars.
11 They might have lost more cash-flow, but we haven't looked at
12 it from that perspective.

13 Q And for every dollar of cash that Canada is short who
14 made that up?

15 A The other entities.

16 Q Now, you talked a little bit on cross about Rockport
17 Canada owing Rockport for prepetition inventory. How much
18 inventory has Rockport Canada received that it hasn't paid
19 for?

20 A I don't know the exact amounts, but fundamentally if
21 the intercompany says its \$18 million dollars, its \$18
22 million dollars of inventory because that's really the only
23 thing that's in the intercompany balance.

24 Q You were questioned a bit about how the borrowing base
25 certificate might be conservative and that's because it might

1 apply an extra percentage to net liquidating -- to estimate a
2 liquidation value. Is that percentage applied across the
3 board?

4 A Yes.

5 Q Would that percentage alter the proportion of assets
6 attributable between US and Canada?

7 A No. It would change that. It just would change maybe
8 we'd have more availability, but as you can see on the one
9 borrowing base from April 15th we were already over the limit
10 anyway.

11 Q You were asked a bit about Exhibit 3 on cross. Does
12 Exhibit 3 address incoming sale proceeds at all?

13 A No.

14 Q Does it address --

15 THE COURT: I'm sorry. Can you ask that question
16 again, does it address what?

17 MR. KANDESTIN: Incoming same proceeds.

18 THE COURT: Okay.

19 BY MR. KANDESTIN:

20 Q Does Exhibit 3 address in any way what the debtors
21 anticipate will be left behind at Rockport Canada?

22 A No.

23 Q The ABL facilities are over-secured, right, in the US?

24 A Yes.

25 Q Presently or as of the petition date are there enough

1 assets in the US such that if the ABL lenders wanted to
2 foreclose on US assets only there would be enough to satisfy
3 their claim?

4 A Based on the borrowing certificate?

5 Q Based on your knowledge as interim CFO?

6 A I would say no.

7 Q I'm sorry.

8 A I can't -- can you ask again.

9 Q So, you were asked on cross about whether if the ABL
10 lenders -- whether the ABL lenders would have a claim that
11 trickles into Canada. Do you recall that testimony?

12 (No verbal response)

13 Q Is there any reason to anticipate that there would be a
14 claim that trickles into Canada above and beyond its
15 allocated 18.4 percent allocation?

16 A No.

17 Q Is it important to the debtors to have a cushion
18 provided by DIP financing?

19 A Yes, absolutely.

20 Q How so?

21 A I personally fought hard for it. Originally when we
22 looked at and looked at the sizing it probably could have
23 been lower, but we needed enough to go to our vendors and say
24 we have plenty of financing, there would be no issues, there
25 would be no shortfalls because, again, we needed the

1 factories to continue on.

2 So, it was important to have excess availability so
3 that we could continue going. Plus, if it dragged out, which
4 happened prepetition as well -- if it dragged out we would
5 have excess cash to get through the transaction.

6 MR. KANDESTIN: I have no further questions, Your
7 Honor.

8 THE COURT: Mr. Kosturos, you may step down.

9 THE WITNESS: Thank you.

10 (Witness excused)

11 THE COURT: Your Honor, the debtors call Nathan
12 Court.

13 NATHAN COURT, WITNESS, SWORN

14 THE CLERK: Would you please state your first name
15 and spell your last name for the record?

16 THE WITNESS: Nathan Court, C-O-U-R-T.

17 THE CLERK: Thank you. You may be seated.

18 MR. KANDESTIN: May I proceed?

19 THE COURT: Yes.

20 DIRECT EXAMINATION

21 BY MR. KANDESTIN:

22 Q Good afternoon, Mr. Court.

23 A Good afternoon.

24 Q By whom are you employed?

25 A Houlihan Lokey.

1 Q And what is Houlihan Lokey?

2 A An investment bank financial advisor.

3 Q What is Houlihan's role in this case?

4 A We are the financial advisor to the debtors.

5 Q And what is your current position with Houlihan?

6 A I'm a director in the financial restructuring group.

7 Q How long have you been doing that type of work?

8 A Thirteen years approximately.

9 Q Have you had experience before with DIP financing?

10 A I have.

11 Q What is that experience?

12 A On the debtors' side I've worked on Powerwave and
13 Advanced Marketing Services which were both Delaware cases
14 and on the creditor's side, among others, TerreStar,
15 LightSquared, VeraSun.

16 Q I have a few questions for you about allocation. Is
17 the exhibit binder up there still?

18 A Yes.

19 Q Will you please turn to Tab 3 of the exhibit binder?

20 A Are you familiar with Exhibit 3?

21 A Yes.

22 Q What is it?

23 A It is the analysis that shows the allocation of the DIP
24 between US and Canada as 18.4 percent.

25 Q Was Houlihan involved in preparing this document?

1 A Yes.

2 Q And are you familiar with this document?

3 A Yes.

4 Q Can you briefly explain how Exhibit 3 arrives at the
5 18.4 percent allocation?

6 A So, you know, the way this works is it, obviously, has
7 US and Canada and then it has categories of working capital.
8 The gross numbers come from the company's balance sheet; it's
9 basically an accounting entry. The adjustments reflect, as
10 Mr. Kosturos said, various reserves and then, in particular,
11 with respect to the inventory there is net orderly
12 liquidation value applied which the ABL lenders received from
13 a third-party appraisal company which they employ when
14 they're doing this work. You know, you back those out and
15 you get the net. The net is what they used to calculate what
16 they're willing to lend to the company. Then, when you break
17 it up between US and Canada the Canadian portion at this
18 point in time was 18.4 percent.

19 Q Why did the debtors not use gross value?

20 A Gross value isn't what's lent against.

21 Q Did you run an analysis to see what the proportion
22 would be had you used gross value?

23 A We didn't. I believe it was higher. It was like 20.9
24 percent.

25 Q Can you turn to Tab 4 of the Exhibit binder, please,

1 and to Page 16?

2 A Excuse me; what page?

3 Q 16. I'll offer you the same paragraph that I referred
4 Mr. Kosturos to, Paragraph 37(d).

5 A Okay.

6 Q I'd like to ask you about the format that's proposed
7 there. Did the debtors consider it reasonable to allocate
8 debt based on the proportion of which debtors drew directly
9 from the ABL facility?

10 A No, because the debt is -- Canada and the US are
11 jointly responsible for the debt and Canada benefited from
12 the ABL.

13 Q The second proposed method is Paragraph 37(d) is
14 comparison between the estates revenue between global
15 revenue. Did that form part of the debtors' allocation
16 method?

17 A It did not. You know, we looked at it, but, again,
18 this isn't a global ABL. It refers just to US and Canadian
19 collateral.

20 Q How about the third proposed method there, estimated
21 liquidation evaluations. How does that compare to the
22 borrowing base method?

23 A That is very similar to the borrowing case. That is
24 basically what the borrowing base does.

25 Q How so?

1 A Because it applies a net orderly liquidation value to
2 the various components of inventory. It applies a discount
3 to the accounts receivable to account for, you know, trying
4 to recover on those receivables in a liquidation.

5 Q And the final method in Paragraph 37(d) is Canadian
6 assets versus global assets. Did that form part of the
7 debtors' allocation method?

8 A It did not, but we looked at it and same issue with
9 revenues. This is a US and Canadian ABL.

10 Q To allocate the ABL debt do the debtors believe that
11 it's necessary to know in advance the incoming sale proceeds
12 to any particular entity?

13 A No.

14 Q Why not?

15 A Because, frankly, those proceeds are unknowable. At
16 this point they could change, but the debtor, itself, is a
17 historical number that we can calculate today.

18 Q Is there some other debt allocation method that the
19 debtors know of that they believe is more reasonable than the
20 one they're proposing today?

21 A No.

22 Q Is it important for the debtors to get final approval
23 of the DIP financing facility today?

24 A Yes.

25 Q Why is that?

1 A Because we need a final DIP order or we face an event
2 of default. We need the DIP financing for operating
3 purposes.

4 MR. KANDESTIN: No further questions, Your Honor.

5 THE COURT: Cross?

6 MS. PILLON: No questions. Thank you.

7 MR. KANDESTIN: The debtors have no further
8 witnesses.

9 THE COURT: You may step down.

10 (Witness excused)

11 THE COURT: Does the information officer wish to
12 put forward any witnesses?

13 MS. PILLON: Elizabeth Pillon, Stikeman Elliot,
14 for the record.

15 I don't on the basis that the report is in and I
16 may be referring to a couple of numbers out of the report.

17 THE COURT: The report is in.

18 MS. PILLON: Thank you.

19 THE COURT: Okay. Let's take five minutes and
20 then we'll go to argument.

21 (Recess at 3:35 p.m.)

22 (Proceedings resume at 3:43 p.m.)

23 (Call to order of the Court)

24 THE COURT: Please be seated. Mr. Collins.

25 MR. COLLINS: Yes, Your Honor, thank you.

1 Your Honor, I think we had quite a bit of dialogue
2 before the testimony, so I will do my best to be brief and to
3 summarize what I think was uncontroverted testimony from our
4 witnesses, and why we think it's --

5 THE COURT: Can we start out with what's the
6 standard and what am I supposed to be ruling on here?

7 MR. COLLINS: Okay. Sure.

8 I will -- Your Honor, I'm fine with thinking that
9 this is our burden. We are seeking to -- we are the movant.
10 We are seeking to allocate debt amongst the various debtor
11 parties. And we think we have met that burden by having
12 really uncontroverted testimony as to the fair method of
13 allocation.

14 THE COURT: But we're in a context, right?

15 MR. COLLINS: Yes.

16 THE COURT: So, but what's the standard that I'm
17 judging this by? This is adequate protection? This is --
18 what is this? And, yeah, what's the standard? Not just did
19 I prove by the preponderance of the evidence I'm assume
20 you're going to say --

21 MR. COLLINS: Yes.

22 THE COURT: -- that this is a reasonable
23 methodology. Do you have to prove it's the best? It's the
24 reasonable? But we're here in a DIP context, so how am I
25 supposed to judge this?

1 Do I judge this like a request for a 506(c)
2 waiver? Do I just this like a request? What do I judge this
3 like?

4 MR. COLLINS: I think you would judge this based
5 upon when you have joint and several obligors before you with
6 a valid, for all intents and purposes, appears to be a valid,
7 first priority secured claim. And for purposes, one of, not
8 necessarily adequate protection, but certainly a condition to
9 borrowing in that it's appropriate for a lender to know what
10 the capital structure of a company it's lending to, to
11 understand what its liabilities are and what it's going in
12 subordinate to.

13 THE COURT: Well, it knows that.

14 MR. COLLINS: Not necessarily, Your Honor.

15 It could be all from the United States goes to pay
16 down the ABL. That's a very different credit decision.

17 THE COURT: But that's not the -- it knows the
18 capital structure. It knows what it lent into. Okay, right?
19 The seconds or the noteholders know they lent into a
20 situation where they got a first on certain collateral, a
21 second on other collateral, and nothing -- no lien on other
22 collateral of the global entity, right?

23 MR. COLLINS: Correct.

24 THE COURT: So, they knew that. They know what
25 they lent into.

1 MR. COLLINS: True, but they lent in junior on the
2 EBL priority collateral which is a significant portion of the
3 value of the business in, you would think AR and in
4 inventory. And then, obviously, the other components of the
5 debtors' business. And they are going in subordinate to
6 citizens on that EBL priority collateral for their new money,
7 as well as their adequate protections is also subordinate to
8 citizens on the ABL collateral.

9 And I think it's fair to say what is my borrower
10 obligated to pay on account of that senior secured ABL
11 facility? And in many respects, I view this as akin to
12 determining contribution amongst jointly liable parties. And
13 you're trying to do in a fair and equitable way in order to
14 allow the case to move forward.

15 This is a threshold issue for purposes of new
16 money coming into the company. This methodology, we believe,
17 is fair. We think it's really not subject to attack. We
18 heard only in papers. The other theories are methodologies
19 that the information officer thought might be considered. We
20 went through them in detail, each one.

21 And, in my view, and I think the testimony was
22 clear, none of those are even close to being fair or
23 appropriate for allocating this type of liability.

24 THE COURT: And why is that? I heard the
25 testimony, but why is the testimony correct? Why is that

1 judgment correct?

2 I heard I'm allocating and among the borrowers.
3 The Canadian debtors, the Canadian debtor benefitted
4 indirectly and they benefitted.

5 MR. COLLINS: Yes.

6 THE COURT: But don't I have other entities in
7 this corporate group that benefitted from the ABL that are
8 not being included in the allocation?

9 MR. COLLINS: They are not liable on that secured
10 debt.

11 THE COURT: They're not, but they benefitted from
12 it.

13 MR. COLLINS: Very different situation, Your
14 Honor, where you've got a debtor entity that is a primary
15 borrower and guarantor. That is what it is. That is a valid
16 secured claim and recognizable under the law.

17 THE COURT: It is, but I heard that they also
18 benefitted from it, so should I be looking at benefit?

19 MR. COLLINS: No. I think you look at benefit to
20 ensure that there's not unfairness in how you allocate. And
21 that is why we went through that analysis to show it's not
22 just that they are contractually obligated as a
23 borrower/obligor/guarantor. It's that they received real
24 actual benefits to that estate. And, as a result, it's fair
25 to apportion a portion of the liability to that estate.

1 And when we hear the testimony that \$18 million
2 dollars appears of inventory sales from the United States
3 went to Canada, that was not paid for, that in and of itself
4 shows that Canada benefitted from this ABL facility.

5 And we have uncontroverted testimony that the
6 borrowing base certificate shows that citizens relied upon
7 the Canadian collateral to make dollar for dollar loans. And
8 all we're seeking to do today is to set the amount of the
9 secured claim against these debtor entities.

10 THE COURT: Are we doing that because Mr. Kosturos
11 wasn't clear on that. In fact, his testimony was I don't
12 know if there's some other liability out there.

13 MR. COLLINS: No, I think the -- maybe that was
14 more of a legal question and how this order is the legal
15 effect of this order. But this order is setting in stone the
16 18.4 percent allocation.

17 THE COURT: And what does that mean?

18 MR. COLLINS: That means out of the Canadian
19 proceeds of sale that will be determined in the future, after
20 the administration charge, in accordance with Canadian law,
21 the first monies then out pay this senior secured claim.

22 THE COURT: Up to the amount of a certain dollar
23 amount.

24 MR. COLLINS: \$10.4 million; right. Assuming --
25 it's no different than under 506(b) is what is the value of

1 the collateral securing your secured claim? Is that, is this
2 now allocated portion of secured debtor undersecured or
3 oversecured. We will know when we complete the sale and we
4 determine what the appropriate sale proceeds allocation is.

5 Clearly, through the questioning of Ms. Pillon,
6 they believe strongly that just on the collateral values, the
7 cost value of the inventory, value of the accounts
8 receivable, they're in the money by quite a bit. But that's
9 not being decided today.

10 It would not be fair to decide sale proceeds
11 allocation in the context of a DIP financing order. It is
12 appropriate in the context of a DIP financing order to
13 determine what your prepetition secured debt is amongst your
14 borrowers, so that your lender is willing to lend to that
15 estate.

16 We do that all the time in DIP orders where the
17 debtor stipulate that this is the value of the secured debt
18 and then we have an investigation period. And no one knows
19 at the end of the day are they oversecured, undersecured. We
20 all have a view, we think, going in, but we don't decide
21 value of secured debt. We don't make 506(c) decisions based
22 upon an allowance of secured claims, the principal amount of
23 the secured claim, in a DIP, but you certainly set what the
24 amount of the secured claim is.

25 THE COURT: Is this all subject to challenge in

1 terms of the underlying validity extent, priority, et cetera?

2 MR. COLLINS: Yes, it is.

3 THE COURT: So, if it were to be determined that,
4 in fact -- well what --

5 MR. COLLINS: Yes. If a committee does a
6 challenge and it's found out that the ABL entity does not
7 have valid liens and claims, then it's not a secured claim.
8 This is assuming it is a valid secured claim. We certainly
9 have stipulated that it's a valid secured claim. It's
10 subject to the investigation period, and this is how we
11 believe you allocated amongst these debtor borrowers.

12 And this has gone out, you know, on notice. We
13 served every Canadian creditor with a DIP motion, as well as
14 a notice saying part of this DIP, we're seeking to allocate
15 the secured debt. We have the testimony. We have
16 declarations.

17 I mean we have gone about this in the best way
18 possible so that if anybody had an issue with what it is we
19 are doing, they can stand up here today and either oppose it
20 or propose alternative that you think is more appropriate or
21 fair. And we have no alternative methods that come close to
22 that.

23 The uncontroverted testimony revenue doesn't make
24 sense. You're looking at revenue from foreign entities that
25 aren't even borrowers on the ABL vet. That doesn't make

1 sense. Asset values on the global enterprise. The ABL can't
2 look to Korean assets to foreclose upon, but they can
3 foreclose upon this entirety the ABL collateral up in Canada.

4 So, is this a gating item? Yes. Does it in any
5 way determine the amount of distributions to Canadian
6 creditors? No. Does it determine who our -- what are the
7 amount of the Canadian creditors? No.

8 That is all left like any Chapter 11 case to the
9 process that unfolds through your 363-sale transaction and
10 then plan confirmation.

11 And on some level, Your Honor, when you look at
12 contribution allocation, I think you have to look to
13 fairness. What is equitable under the circumstances? And I
14 know that's squishy, but that, ultimately, is what it is. I
15 mean I really believe that is the test.

16 When looking at this situation with these unique
17 facts, is it appropriate to allocate across the borrowing
18 base certificate, because that's what the lender relied upon
19 in making the loan and would look to in order to be repair.
20 We think so, especially where that entity is a net user of
21 that DIP facility.

22 And the testimony is uncontroverted that while
23 they did not borrow directly, that was not the debtors'
24 custom, it was, again, potentially for efficiency sake.
25 Maybe Citizens didn't want to deal with Canadian dollars in

1 making direct loans. I don't really know.

2 But it was clearly done so that it all funneled
3 through Rockport Company. They were the primary borrower.
4 They then distributed the inventory. That doesn't mean,
5 however, that those other entities are not liable as secured
6 obligors for that debt.

7 THE COURT: Well, they are --

8 MR. COLLINS: They are.

9 THE COURT: -- at least, that's what it looks like
10 they are, and they're certainly the parties to the loan
11 documents.

12 MR. COLLINS: But, certainly, the IO has challenge
13 rights, I assume, as a party in interest, which we certainly
14 would agree they're a party in interest, to look at the
15 validity of the liens and claims of the ABL lender.

16 This allocation assumes that those liens and
17 claims are valid. That investigation period has not expired.
18 So, that can be undone.

19 We did our own analysis. We think they are
20 perfected. We don't believe there are any tort claims or
21 other type of underlying liability claims. This is a
22 straightforward ABL facility. And we are -- we are trying to
23 do this in the open.

24 We have now the support of our unsecured creditors
25 committee and that should not -- I don't think that should be

1 -- I think there's some material importance to this estate or
2 to this issue. Because you have fiduciaries to all of these
3 estates who believe that this is an inappropriate way for
4 these cases to efficiently move forward.

5 THE COURT: Well, they believe that because
6 there's been a demand put on them by the noteholders to
7 obtain this ruling upon penalty of the DIP. That's why
8 (indiscernible) thinks so.

9 You would not be in front of me today if it were
10 not a condition of the DIP for this to be resolved.

11 MR. COLLINS: I guess, I would say, it depends on
12 if that's a reasonable demand or not.

13 THE COURT: Well, I think that's exactly right.
14 And we've been debating that in chambers. Is this a --
15 again, what's the standard, what's the rubric in which I a
16 taking at this?

17 This is a DIP hearing where the DIP lenders have
18 made multiple requests for what they want and what they
19 require as a condition to lending. They required a roll-up,
20 which they got; at least, in part.

21 They got some liens on unencumbered assets.

22 They got some significant fees.

23 They got a whole bunch of things and here's
24 another request. So, how do I -- that's what I'm saying.
25 How do I view this and do I view this in the context of all

1 the requests? And do I say are all of these requests
2 reasonable or do they tie the hands of the debtor or not?

3 That's what I'm saying. How do I look at this and
4 is this a reasonable request?

5 MR. COLLINS: I think you can look at in many of
6 those situations. They probably all apply to some degree to
7 this analysis. Is that -- is it part of the total package of
8 the financing? Yes. Okay. It doesn't mean, though, that
9 simply because it's part of the total package that it has to
10 be approved. But Your Honor could look at it and say I'm not
11 going to approve it and, therefore, the facility would not be
12 approved.

13 But what happened with the roll-up, the liens on
14 unencumbered assets, the carve-out? Your Honor determined
15 that the interim hearing, and I'm hoping at the end of today
16 that the terms of the financing themselves are fair and
17 reasonable and appropriate.

18 And we certainly have the testimony that these
19 were the best terms available. It provides the company with
20 a runway to do a going concern sale. This going concern sale
21 does not just benefit the noteholders. This, likely, will
22 employ upwards of 70 percent of the corporate employees.
23 We're paying a substantial amount of foreign vendors claims,
24 upward of \$25 million dollars that were outstanding as of the
25 petition date. We're assuming executory contracts.

1 This is a going concern sale. They are not the
2 sole beneficiary of this. Well, just put that on a shelf.

3 And then you look at and say, okay, well now
4 they're asking about this allocation. And is it appropriate?
5 Is it fair? And I think Your Honor should look at it from
6 that perspective.

7 Is the allocation that's being proposed fair and
8 reasonable? Is it equitable? Has it been put out on notice?
9 Has there been an opportunity to have a contested hearing?
10 Have people make their arguments as to what is appropriate or
11 not. And that has all happened.

12 And what you have before you, I believe, is a
13 methodology that no one has credibly attacked. What you did
14 see from the information officer was, well maybe how about
15 this or how about that or how about this. But I didn't hear
16 any cross-examination that went to the unfairness of the
17 allocation of the ABL debt.

18 What I did hear were questions that really went
19 more to how one allocates sale proceeds. And doesn't this
20 make sense that if these collateral values that are set forth
21 in a borrowing base certificate must be very conservative. I
22 think that means she believes that that \$11.4 million that's
23 there as the net collateral value and you have \$10.4 million,
24 she must believe that value is much more than 11.4 if she
25 wasn't arguing why it was so conservative. Right?

1 So, you that is what was argued. Not the merit of
2 the ABL allocation methodology itself. And I think that is
3 critical to look at the overall nature of this request.
4 Especially when you look at the benefits to the estate of
5 having the financing and the issues that are left for another
6 day including the allocation of the sale proceeds itself, the
7 plan process, who gets what. Those issues -- none of those
8 issues, those are plan issues are not being determined today.

9 THE COURT: The store closing sales that may go
10 forward soon.

11 MR. COLLINS: Yes.

12 THE COURT: Am I correct in assuming that the
13 liquidation sales in Canada, that money would stay in Canada?

14 MR. COLLINS: Yes. Until further order of the
15 court.

16 As was mentioned, we agreed to ringfencing. It
17 seems appropriate because this is -- the capital structure in
18 Canada is different than the United States, and we get that.
19 And it is appropriate, at this point, to put a noose around
20 it and let things move forward.

21 Some day there will need to be, you know, a
22 reconciliation of all of that. But all we're doing is
23 allocating a secured debt at this point. No money is leaving
24 Canada. All they are doing at this point, Your Honor, is
25 paying the U.S. for any current goods that are acquired post-

1 petition. Everything else is frozen, as requested by the
2 buyout and was set forth in our cash management order and
3 will continue to be that way pending further order of the
4 court.

5 That's all I have, Your Honor. I think anything
6 else I say will just be repeating myself, so.

7 THE COURT: Thank you.

8 MR. COLLINS: Yes.

9 THE COURT: I'd rather, actually have everybody,
10 who's in support go first. And then I'll let Ms. Pillon
11 respond.

12 MR. WINNING: Thank you, Your Honor, of Cooley
13 LLP, proposed counsel for the committee.

14 I don't have much to add and think that covered
15 everything. But Your Honor did sort of ask if we agreed to
16 this because there was a gun to our head or if we thought it
17 was reasonable.

18 At the end of the day, we negotiate these things
19 with a lot of guns to our head. But some allocation has to b
20 made and when we agreed to this, as part of the settlement we
21 reached, it was because we did think it was reasonable for
22 the reasons you heard on the stand today and from Mr.
23 Collins.

24 THE COURT: Thank you.

25 THE COURT: What else? Ms. Pillon.

1 MS. PILLON: Liz Pillon, Stikeman Elliott, for the
2 information officer.

3 Your Honor, you're being put in a tough spot being
4 asked to deal with a matter potentially prematurely. You're
5 being told a lot of things will happen if the DIP is not
6 approved today. We, as a court officer, understand that as
7 well.

8 We understand that, as my friend says, we're not
9 the sole beneficiary of the entire sales process. But what
10 we're trying to do here is make sure we're not
11 disproportionately held responsible for it.

12 And from the debt structure that is already in
13 place, and we walked through that earlier when I had my
14 initial submissions, the debt structure that's already in
15 place, what people thought about Canada and looked to the
16 Canadian assets for including these noteholders and three
17 amendments, they weren't looking to Canada.

18 And --

19 THE COURT: Well, they didn't give up Canada.
20 They didn't say don't be a borrower. Don't be a guarantor.
21 They weren't letting Canada draw, but they weren't saying we
22 don't want you obligated to pay this debt.

23 MS. PILLON: For the ABL, fair enough.

24 For the ABL, we were -- Rockport Canada was a
25 zero borrower and a guarantor. For the notes, in terms of

1 what the notes' expectations and requirements and valuations
2 for them to now being saying it is critical for us to have
3 this as a term of our DIP on the last tranche of the money to
4 get us to the finish line of the closing is to no look to a
5 Canadian bunch of assets that we didn't look to before, three
6 amendments and a DIP. And we didn't look to it before seems
7 like there's a little bit of extra focus on Canada that's not
8 necessary.

9 And we are trying to find a way to either leave
10 this issue to another day when this court has all of the
11 information before it with respect to proceeds. I'm
12 realistic that you're being told the sky will fall if you
13 don't approve this today.

14 THE COURT: But why do I need the information
15 about proceeds to make this allocation decision?

16 MS. PILLON: I think it helps you look at whether
17 it's actually fair. So, there's two issues.

18 On Exhibit 3, it was put to Mr. Kosturos on those
19 numbers, so they're either stripping out too much or they're
20 not willing to set a floor for the other creditors. That's
21 the problem with the 18.4

22 So, on the Exhibit 3, if you have that in front of
23 you, the Canadian assets total collateral value is \$11.4
24 million --

25 THE COURT: Let me get that.

1 MS. PILLON: Sure.

2 THE COURT: I don't know what I just did with it,
3 but I. . .

4 UNIDENTIFIED SPEAKER: We have an extra copy if
5 you --

6 THE COURT: No, I got enough paper. Here, we go.
7 On Exhibit 3, gotcha.

8 MS. PILLON: So, on Exhibit 3 the Canadian
9 collateral was \$11.4 million dollars. If you approve the
10 allocation agreement my friends put to you and the DIP lender
11 says is necessary, you will be agreeing to \$10.483 million
12 dollars' worth of debt coming out of Canada.

13 And, to be clear, the other priority payables that
14 we say the Canadian estate should first pay before any other
15 lender gets paid would be -- it's not -- everybody keeps
16 saying the charge. It's actually priority payables.

17 It could be taxes. It could be liens. There's
18 some construction liens. There's some debate about who else
19 would be in priority. So, it's not just a \$300,000-dollar
20 charge. There could be others ahead.

21 So, the effect of this ABL allocation on their
22 numbers, you should just recognize that you maybe basically
23 signing over all of the Canadian assets to the noteholder on
24 their figures.

25 The other valuation --

1 THE COURT: It's a million dollars difference.

2 MS. PILLON: Right. Of which you've the charge.

3 You've got potentially some other priorities. And you have
4 the cost of running it down in Canada.

5 THE COURT: And I have a \$60 million-dollar ABL.

6 MS. PILLON: Yes.

7 On the other side, other figures that we see,
8 including in their reports, which I have a reference for you,
9 but in their reports at paragraph 37, when I look at what do
10 I know about the Canadian assets, paragraph 37 of the
11 information officer's report, February 2018, there was \$40.9
12 million Canadian assets and of which \$24.3 million dollars of
13 inventory on the books.

14 Well, that seems to me like there could be a fair
15 bit left over for the Canadians. And, so when we ask for
16 things like what do you know and what do you think will be
17 left for the Canadians and no one can just say don't worry.
18 We'll leave aside. We can earmark money for you. Everything
19 will be fine. Everybody says Canadians don't worry. You
20 wait.

21 THE COURT: Well, what's also interesting, though,
22 in that section of the report is that 90 percent of the -- if
23 my numbers right. Ninety percent of the 40 point -- no, of
24 the \$36.5 million dollars in liability is intercompany debt
25 to the American debtors.

1 MS. PILLON: Right.

2 THE COURT: To the debtors. So, 90 percent of
3 Rockport Canadian's indebtedness is to the other debtors.

4 MS. PILLON: Eighteen of which is based on what
5 we've heard is inventory related or supply related. The rest
6 is with respect to a previous transaction.

7 THE COURT: Okay. But does that leave, at least
8 my math, that's about four million dollars in unrelated pre-
9 bankruptcy debt to non-affiliated entities. About four
10 million of --

11 MS. PILLON: Unsecured, yes.

12 THE COURT: -- unsecured debt --

13 MS. PILLON: Yes.

14 THE COURT: -- to unaffiliated entities.

15 MS. PILLON: Yes. The validity of which is still
16 subject to debate, but yes.

17 THE COURT: I guess the validity of all of that is
18 subject to debate.

19 MS. PILLON: Yes.

20 THE COURT: But is what I'm looking at here, at
21 least, based on what the information officer has been able to
22 review, and recognize it's unaudited, I'm sure, from his
23 standpoint, is a universe of four million dollars of
24 prepetition unsecured debt.

25 MS. PILLON: Well, you don't have the ABL listed

1 in the balance sheet at all.

2 THE COURT: Putting the ABL aside.

3 MS. PILLON: That is our best guess on February
4 2018 of which the intercompany, there may be a chunk of it
5 which is subject to debate.

6 THE COURT: Okay.

7 MS. PILLON: Which, again, because we're dealing
8 with it today, as you said, we've got an investigation
9 period. We've got to determine things. Claims would put
10 forward.

11 But what that does, from the information officer's
12 point of view, is it either says this allocation takes
13 everything out of Canada or somebody can't admit that there's
14 a lot of money left or, potentially, a lot of money left for
15 Canada that we could then ringfence and protect our
16 creditors, in which case, we all walk over to the Canadian
17 court, hand-in-hand together, and say, yes, with this ability
18 and with these added protections, all right, we both get what
19 we want.

20 The noteholders get their ability to take 18.4
21 percent out. The Canadian creditors have their own
22 ringfencing and its protected. And if there's something left
23 after that, then, you know, we'll be continuing. We'll go out
24 and sell the retail sales, the stores, and we will ringfence
25 for the rest.

1 Then, we know each side is getting something out
2 of Canadian, as opposed to take it out of Canadian for the
3 noteholders. Canadians wait and see.

4 THE COURT: So, you think the fairness that I need
5 to look at, Mr. Collins says this is fair, and that's what I
6 should be looking at. How do we make a fair allocation?
7 Your argument is I can't make a fair allocation of the debt
8 if I don't know what's left for Canadian creditors?

9 MS. PILLON: Or ringfence something for the
10 Canadians so that they know that they're being protected.
11 So, if nine million dollars comes out for the ABL and five
12 million dollars gets held for the Canadians, and then we can
13 all share it kumbaya in the future, so be it.

14 But, at least, then there is a carve-out. And the
15 Canadian creditors don't need to worry about I'm only relying
16 on what the UCC might get in its GUC in the future.

17 THE COURT: But hasn't the Canadian court in its
18 order, its supplemental order, it's already told us certain
19 things about the priority and charges of claims against the
20 Canadian entity. First, there's an administrative charge to
21 the maximum amount of \$300,000 dollars. And, second, is the
22 DIP lender's charge to the maximum amount of \$60 million
23 dollars.

24 So, at this moment, Canadian unsecured creditors
25 have nothing because it's all taken up by either the

1 administrative charge or the DIP lender's charge. Or am I
2 wrong?

3 MS. PILLON: Well, it's a charge, but how much is
4 actually come out to pay and satisfy that charge is subject
5 to further discussion.

6 The ABL needs to know that the entire \$60 million
7 is there and covered, as it did, in the U.S. when it asked to
8 roll up its DIP. So, the charge is there. And,
9 understandably, how much needs to be allocated to each estate
10 would normally be something that we deal at the end of the
11 piece when we know where all the proceeds are.

12 It's just that we're dealing with today
13 prematurely because of it's a new condition of the DIP. But,
14 otherwise, it's not unusual to say, of course, I've got to
15 have a charge over everything in case I need it. The
16 determination of the split would then be later on.

17 THE COURT: What kind of hearing is the Canadian
18 Court going to have? Let's just say, for sake of argument,
19 that I were -- we'll do both ways.

20 Let's say, first, for sake of argument, I were to
21 approve the allocation as requested. What type of hearing
22 would the Canadian court have on this subsequently?

23 MS. PILLON: They would look to us and, again, and
24 I think it would be basically just the objection that we'd
25 walk them through, just (indiscernible) through it, but they

1 would look and ask what does this mean for the Canadian
2 creditors.

3 They have a tremendous amount of respect for this
4 court, obviously, and deal with it quite often and, so there
5 would be a high level of comity that would be paid. But they
6 have, in the past, and I strong believe he will do it again
7 in this proceeding to determine what, even with that level of
8 comity, what does that mean still. I've got my Canadian
9 creditors to also worry about.

10 THE COURT: What kind of hearing would the
11 Canadian court have on an allocation of debt issue, even if
12 it were done further on at the proceeding or at the
13 conclusion of a proceeding?

14 MS. PILLON: Normally, it would be done
15 consensually and it would need to. But, otherwise, you could
16 go all the way from the information officer providing some
17 estimates, the debtor providing some estimates, all the way
18 to a three-week trial in Nortel on the allocation between
19 estates.

20 THE COURT: Right. So, I was thinking of Nortel
21 and not relishing any of that kind of thought. But I just
22 had a couple of hour hearing where there's been evidence put
23 on as to proper allocation. So, why shouldn't I accept that
24 evidence? And, I guess, the question is, again, and maybe
25 you've answered it, what further do I need for due process or

1 other purposes?

2 MS. PILLON: I think it comes by way of
3 reservation of rights with respect to the future. So, new
4 information come forward, should the issue with respect to
5 allocation of proceeds is a huge one. The issue with respect
6 to allocation of cost is a huge one.

7 The Canadian estate could get out of here on
8 hundreds of thousands of dollars versus millions. And, so the
9 proper determination of all of that is necessary for us to
10 continue to reserve.

11 I think that those determinations should be in
12 front of the courts as opposed to if we deal with them just
13 in a plan unless you want to carve-out the Canadian creditors
14 as their own class.

15 There may be a very unfortunate situation where
16 I'm just swamped in a class, right. And I don't really have
17 the full voice I want with respect to allocation of proceeds.
18 But if it comes back before the courts to determine that
19 issue, and I think we've already telegraphed to you that we
20 have some concerns with respect to how creative we can be in
21 terms of what eventually gets to Canadian.

22 If all the inventory, \$24 million dollars of
23 inventory and accounts receivable -- well, forty million
24 dollars of assets somehow only become \$10.1 million dollars
25 of proceeds allocated to Canada, I think the information

1 officer is going to have something very loud to say about
2 that.

3 And the preference would be that it's being a
4 voice that can come to this court and to the Canadian court
5 as opposed to just being one provision of a larger plan.

6 THE COURT: Well that seems to me an important
7 issue, but somewhat of an aside issue as to whether it would
8 be appropriate to resolve that issue, in what context it
9 would be appropriate to resolve that issue, which his sort of
10 what I'm asking here as well.

11 But, you know, the questions you're talking about
12 is would that be problematic for Canada to receive x amount
13 of proceeds based on y amount of inventory, I suppose depends
14 on what the other assets are and the magnitude and relative
15 scale of recoveries related to other issues. Again, an issue
16 I don't have in front of me.

17 So, whether that's on an absolute scale a problem
18 or not, I don't know.

19 MS. PILLON: Can I pass up a draft of some of the
20 terms that we had proposed to the debtors yesterday? Because
21 this may be -- I appreciate the position you've been put in.
22 So, this may be an ability, a way to -- may I come?

23 THE COURT: Yes.

24 MS. PILLON: And Mr. Collins passed you up, or
25 someone did this morning -- pardon me. I'm not going to give

1 it Mark. I'm just going to hand it to the judge. And,
2 surprise.

3 Someone handed up this morning the debtors'
4 version.

5 THE COURT: Okay. That's what I was going to say.
6 What's the difference?

7 MS. PILLON: Right.

8 THE COURT: So, what I got earlier was a debtor
9 version?

10 MS. PILLON: Right.

11 So, here's what we asked for and what we said.
12 Look, even if, at the end of the day, you're put in this
13 difficult position and you say I have to pick a number. It's
14 \$18.4, it's ten percent, whatever it is, how can you help
15 protect the Canadian creditors?

16 There's a couple of ways of doing that. So, and
17 that's in paragraph 39 of our changes.

18 So, paragraph 39 the changes, first we asked for,
19 were to ensure that all priority payables, including the
20 charge, but all priority payables came off the top before the
21 allocation of any -- the ABL allocation.

22 Slightly different language over on the debtors'
23 version which would water that down a bit, but it should be
24 all priority payables. There could be liens. There could be
25 taxes. Those need to come off the top.

1 The number is specific. It shouldn't be moving of
2 10.8, 10.48. The condition before you in the interim order
3 of what the noteholders needed was the amount as at
4 prepetition. So, the numbers shouldn't be fluctuating. If
5 they'd like to pay it down some, it can go down, but it
6 shouldn't, in any way, be going up.

7 With respect to every dollar that ends up being --
8 the Canadian estate pays down the ABL, and I think Mr.
9 Kosturos in his testimony agreed with this flow of funds.
10 For every dollar that comes out of the Canadian estate, the
11 intercompany should be reduced accordingly. It should be
12 reduced by the economic value of that.

13 It could be dollar for dollar. It could be more.
14 But that's how we framed it as on an economic value. And
15 that only makes sense because it flowed in by intercompany.
16 It's getting paid. The ABL goes down, so does the
17 intercompany.

18 And that helps the Canadian creditors because then
19 if I have ten million dollars at the end of the day, I'm
20 sharing it with less people because the intercompany,
21 rightfully so, have been reduced.

22 The other mechanism of protecting the Canadians
23 would be to have its own allocations so a reserve with
24 respect to the Canadian creditors. So, set aside so that we
25 have, at least, a ringfencing. So, basically, first, or we

1 set aside the liquidation proceeds for the retail sales, some
2 other pool of cash that we know no matter what happens before
3 the 18.4 gets paid, at least, I have something that I can
4 turn to the Canadian court and the Canadian creditors and say
5 something is reserved for you as well.

6 And the final part is paragraph 51 of the
7 blackline, Your Honor. These are the reservation of rights
8 that we believe are appropriate and will keep this in check
9 in the future. And that includes allocation of proceeds of
10 the sale, allocation of the costs, and both of those should
11 come back before the courts. Any claims that the Canadian
12 estate has by way of right of subrogation.

13 So, if, at the end of the day, I, Canadian estate,
14 have to pay down the ABL, presumably, I'm paying it down qua
15 guarantor, since I had a zero borrowing; if I then pay down
16 the ABL, there may be an argument with respect to rights of
17 subrogation. I step into the ABL shoes into the U.S. Estate.

18 That issue is not completely briefed before you.
19 It was actually an issue that was raised as a reservation of
20 rights in our objection. The U.S. debtor then filed some
21 materials, 24-hours before the hearing, and is now, based on
22 their version of the order that they've put before you,
23 suggesting the rights of subrogation issue are, in fact, off
24 the table. So, if you approve the 18.4, the rights of
25 subrogation are off the table. That goes to your question,

1 throughout the day, of what am I doing if I agree to 18.4.

2 But doesn't the right to subrogation undercut the
3 relief that's being requested?

4 MS. PILLON: No, but it keeps people honest later.
5 So, if --

6 THE COURT: How does it not undercut it?

7 MS. PILLON: Well, they originally -- if they are
8 confident that the rights of subrogation don't apply, but I
9 am giving them what they want on the 18.4 in this case. What
10 did they ask for? What was a condition of their notes of the
11 DIP? It was the ability to force the Canadians to pay.

12 Okay. I'm paying, but what does that eventually
13 mean. It could eventually mean that I'm stepping into the
14 shoes of the ABL. I don't know. That's not an issue that is
15 entirely briefed and before you. So, at least, it should be
16 a reservation of rights.

17 The change in the debtors' version of the order to
18 suggest that that now is completely off the table scares me.
19 That should be left for another day, and I think that does
20 have a way of keeping people considering what is the
21 potential claim back with the Canadians over.

22 And, finally, just in terms of having --

23 THE COURT: Would it --

24 MS. PILLON: Pardon me.

25 THE COURT: Would it come back as a -- it would

1 come back as a prior claim, a prior secured claim?

2 MS. PILLON: Yes.

3 THE COURT: You're stepping into the shoes of the
4 ABL. It would come back as a prior secured claim. So, how
5 does that give the noteholders what they are looking for in
6 terms of some certainty about how much debt has to be paid
7 off ahead of them and/or from the U.S. assets?

8 MS. PILLON: Well, I don't know that they fully
9 required it as a condition of the DIP that the right of
10 subrogation was off the table. That was not made known in
11 the papers that were before us and notified on. So, that
12 issue -- if the U.S. debtors and the noteholders believe they
13 have the winning argument, then so be it. But I think there
14 is a future argument to be had with respect to the rights of
15 subrogation.

16 And those fulsome reservation of rights as opposed
17 to the version that you have from the U.S. debtor then, at
18 least, leaves us in a position of I'll be back to discuss,
19 and I hope we can discuss altogether the allocation of
20 proceeds, the fair allocation and a fair allocation of costs.
21 And maybe that means, at the end of the day, we're no worse
22 for wear in Canada. And, if not, then we have an opportunity
23 to come back and you will have heard my concerns already with
24 respect to what step two in this may be.

25 THE COURT: Okay.

1 MS. PILLON: Thank you. Unless you have any
2 questions.

3 THE COURT: Thank you.

4 MS. CHI TO: Your Honor, My Chi To for Debevoise &
5 Plimpton and the noteholders, for the record.

6 So, to be clear, an order that would include the
7 reservation of rights that were just described would not
8 satisfy the requirements of the noteholders, as I believe
9 your last questions indicated.

10 THE COURT: Well that specifically dealt with the
11 subrogation issue.

12 MS. CHI TO: Yes.

13 THE COURT: But what about the other reservations?
14 Why does the --

15 MS. CHI TO: The others were fine, yes. I'm
16 sorry. The last one. I think the subrogation reservation of
17 rights is just a backdoor way of undoing the agreement we are
18 looking for and, as you put it, the comfort we are looking
19 for that there is a minimum, a fair amount of proceeds coming
20 out of Canada to satisfy the ABL debtor.

21 THE COURT: But it's not a minimum, right?

22 MS. CHI TO: Yes.

23 THE COURT: It's a finite number that comes out,
24 that gets used in a certain fashion, right, which pays the
25 priorities and then pays the ABL?

1 MS. CHI TO: In fact, I should have said the 18.4
2 operates more like a cap in terms of the maximum amount that
3 the ABL could look to Canada to repay itself. So, I wanted
4 to clarify that.

5 Also, maybe going back in history. The comments
6 that were made a moment ago about the noteholders' sudden
7 interest in the Canadian assets.

8 We are in front of you today in connection with
9 the DIP that is provided by the noteholders. It's a new
10 credit decision that is made by them or decision to extend
11 money. It's obviously based on the impact of that DIP and
12 the process on their existing investment. If we were not
13 prepetition creditors, we would not be providing the DIP, to
14 be sure.

15 Our starting point was that all the value in
16 Canada should go to pay down the ABL, because the ABL has a
17 first lien on all of those assets. And, in fact, I believe
18 Stikeman has reviewed the validity of the ABL lien and has
19 concluded that it's enforceable and valid under Canadian law.
20 So, that was our starting point. But debtors' counsel
21 quickly told us we can't do that because that's not fair.
22 And, so that was actually this allocation request is the
23 result of a negotiation.

24 And, so we said we understand the full amount of
25 liability of the Canadian debtor is sixty million, or

1 whatever that is, but we understand that's not a fair result.
2 But we still want comfort that there will be some amount, a
3 fair amount, that ends up being paid or borne by the Canadian
4 assets estates, and so that's the history of this negotiated
5 point which has, as I said earlier, I'm repeating myself, but
6 has a very meaningful economic impact on the noteholders,
7 which is why we are, you know, repeating our request that it
8 be approved by the court as a condition to any further
9 borrowings under the DIP.

10 THE COURT: And what do you think the standard is
11 and I'm supposed to use in taking a look at this issue?

12 MS. CHI TO: I agree with what Mr. Collins said
13 earlier. Thank you.

14 THE COURT: Thank you.

15 Mr. Collins.

16 MR. COLLINS: Very briefly, Your Honor.

17 The point of contention that we've had with the
18 information officers is one that is unresolvable in this way.

19 They're looking for a charge for unsecured
20 creditors as part of this allocation. They want an absolute
21 recovery to unsecured creditors in Canadian, regardless of
22 whatever the ultimate outcome is on the allocation of
23 proceeds. We think it's inappropriate and, likely, takes the
24 Bankruptcy Code upside down, to some extent, to say in order
25 to determine an amount of a secured claim, you first must set

1 aside monies for unsecured creditors.

2 THE COURT: Didn't the committee get that?

3 MR. COLLINS: Your Honor, what the committee
4 negotiated was, I think, a fairly standard case resolution.

5 THE COURT: But isn't that what that is? I mean
6 it has become maybe standard. I don't know if it should be
7 or it shouldn't be or it's appropriate or it's not, but we
8 certainly do see it.

9 MR. COLLINS: We certainly do it and let's
10 remember that the Canadian creditors are part of that trust.

11 THE COURT: Yeah, I'm still a little --

12 MR. COLLINS: And it only goes up from there.

13 THE COURT: Still giving that thought.

14 MR. COLLINS: And, like anything, there's
15 reasonableness in the dynamics of negotiations over, over
16 those issues, right.

17 THE COURT: But in this very context, in this very
18 context, in fact, the debtor, with imperfect information,
19 incomplete information, determined, and the committee
20 determined and the debtor is supporting, I assume, that there
21 should be a carve-out for unsecured creditors. How is this
22 different?

23 MR. COLLINS: It's different in that the items
24 that were part of that agreement were to resolve disputes, to
25 create efficiencies within the case. The note debt is on top

1 of the unsecured creditors, so we'd look at it as they are
2 out of the money unsecured creditors. And this is a way to
3 allow them to participate.

4 That book has not been written with respect to the
5 Canadian entity. In fact, it's very possible that there are
6 sums of monies above the amount of this allocated debt
7 allocation for unsecured creditors of Canada. And there will
8 be a negotiation at an appropriate point in time if they are
9 not.

10 THE COURT: Am I in approving or maybe in not
11 approving this, am I changing the leverage? Is that all this
12 is?

13 MR. COLLINS: No, because I think the leverage
14 that the IO has is to argue that any allocation of sale
15 proceeds that leaves unsecured creditors in Canada without
16 any money is an unfair allocation, and they will oppose any
17 allocation in front of the Canadian court, and their
18 allocation will be result oriented to drive a recovery. And
19 their likely will be a negotiations part of that.

20 THE COURT: What happens if I approve this and you
21 go to the Canadian court and the Canadian court says, sorry,
22 Judge Silverstein got it wrong. I'm not going to recognize
23 this. Then what happens?

24 MR. COLLINS: Then we would talk to the lenders.
25 I think we would have problems because it's a condition under

1 both credit facilities that we obtain both a final order from
2 Your Honor and have that order recognized by the court in
3 Canada.

4 I think the process that we have engaged upon here
5 was one that was designed to put a full record before this
6 court. I think that will give Justice McKeown comfort in
7 reviewing the proceedings here. Ultimately, he will make his
8 own decision as to whether or not he believed this unfairly
9 impairs unsecured creditors in Canada based upon the record
10 that you have before you. I don't believe it does.

11 With respect to the subrogation issues, Your
12 Honor, we do think that would simply would be a collateral
13 attack. We note in our brief that 509, I think, (b)(2),
14 there are no subrogation rights when you are, each entity is
15 primarily liable on the debt. By having one pay the other
16 those considerations, so you don't have subrogation rights.
17 We put that in our document.

18 THE COURT: Yeah, that's not my strongest topic,
19 so I'm not so up on subrogation.

20 MR. COLLINS: But the other part of the
21 subrogation argument is we don't want to -- the point of this
22 is that we believe this is a fair and equitable allocation.
23 This, to me, is more, if it's not a subrogation issue, it
24 would be can they come back and seek additional contribution
25 later if they just think it's unfair. And I think that's

1 what we're doing here today. This is the point of this is to
2 set this allocation, give some certainty to the lenders as to
3 how we are going to deal with this jointly and obligated
4 senior secured ABL debt.

5 So, for that reason, we would not agree on that
6 language. We certainly agree on reserving a cost allocation
7 and a sale proceeds allocation.

8 On the dollar-for-dollar issue if, and I'm
9 speaking out of turn here, but if this is what it takes for
10 us to get past this, I would like to have a short break to
11 speak to my client about that.

12 You heard Mr. Kosturos' testimony. The
13 intercompany claim is built upon the transfer of inventory.
14 And we have certainly talked, on our side, about should we
15 just do that now or should that just be part of a later
16 process, and I'm happy to have that conversation if that
17 moves the ball in any way on this issue.

18 THE COURT: Well, I think you should turn to Ms.
19 Pillon and see if it moves the ball, but this whole hearing
20 is sort of an unusual posture where I feel like I'm sort of
21 part of a negotiation.

22 MR. COLLINS: No, and I apologize.

23 THE COURT: I'm not, I'm not wanting to be part
24 of.

25 MR. COLLINS: And I understand that. It's just

1 that she mentioned these asks that she wanted and I want to
2 respond to the ask, if it helps. And I understand it's
3 inappropriately negotiated at the podium, although we
4 probably do it way too often as bankruptcy lawyers.

5 THE COURT: I think it was appropriate, quite
6 frankly, to cede the back and forth, in this sense, that in a
7 more traditional DIP hearing, the court certainly takes a
8 look at whether the asks are appropriate and reasonable by
9 the lender, and then can say yes or no, or, you know, here's
10 how I would -- here's something I would approve. And then,
11 of course, it's up to the lender to decide what the lender is
12 doing. But I think from that standpoint, it's helpful to
13 understand what could make the debtors' request more
14 reasonable or more fair.

15 MR. COLLINS: We agree.

16 THE COURT: Okay. Well, I hear the request and
17 the testimony that there be a decision today, but there's not
18 going to be. It's quarter to five. I think this is a very
19 important issue for this case. I need to give it some
20 thought. And I have first days tomorrow in a new case, and I
21 haven't read the page. As I said, I want to give this some
22 thought.

23 I will rule from the bench. And I will either do
24 it tomorrow or Friday. My understanding of the testimony is
25 that there is money currently. We're not in a money tight

1 situation that there's not going to be a draw next week. So,
2 I understand the condition and maybe there's a milestone in
3 the DIP, but I'm not going to rule on this today. I'm not in
4 a position to rule on this today. I want to give some very
5 considered thoughts to this, I will say, unusual request in
6 the context of a DIP motion, although, clearly, the issue
7 will have to be decided at some point in time in this case.

8 Yes.

9 MS. KEILSON: Good afternoon, Your Honor, Brya
10 Keilson on behalf of the United States Trustee.

11 THE COURT: Yes.

12 MS. KEILSON: As I think you might have hinted on
13 a little bit, today is the first time that we've heard about
14 the settlement with the creditors committee. It raises our
15 intent a little bit in terms of potential issues with regard
16 to the GUC trust and being rolled into the DIP order.

17 The parties have agreed to provide us with a copy
18 of the updated order before submitting it to Your Honor. To
19 the extent there are any issues that are raised, from our
20 perspective, we reserve the right to ask to consult with the
21 court in a conference if we're not able to resolve it with
22 the other parties.

23 THE COURT: Okay.

24 MS. KEILSON: Thank you.

25 THE COURT: Yes.

1 MR. O'NEILL: Excuse me, Your Honor. May I have
2 just a minute with Mr. Collins. Thank you.

3 MR. SCHLAUCH: Good afternoon, Your Honor. For
4 the record Brendan Schlauch, Richards Layton & Finger on
5 behalf of the debtors.

6 We have a couple of other items remaining on the
7 agenda today. Sorry.

8 (Laughter)

9 MR. SCHLAUCH: Hopefully, they will be less
10 interesting and controversial.

11 The first one is its item number 21 on the agenda.
12 It is Houlihan Lokey's retention application. I have a clean
13 and blackline, if I may approach.

14 THE COURT: Yes.

15 MR. SCHLAUCH: So, Your Honor, as discussed
16 earlier this morning, the committee, I guess, the debtors did
17 receive informal comments from the United States Trustee, and
18 the committee filed a limited objection to Houlihan's
19 retention.

20 The settlement with the committee, which will be
21 embodied in the DIP order is -- they withdraw that rejection.
22 As a result, this is an uncontested item. I can walk Your
23 Honor through the blackline. The UST has signed off on this
24 form of order. These changes were just things that the UST
25 requested, some clarifying comments and, you know, Houlihan

1 did sign off on it.

2 THE COURT: I did not look at this. I didn't get
3 to it. Can you give me the highlights of what the
4 commentation structure is?

5 MR. SCHLAUCH: Sure. So, Houlihan will receive a
6 -- or the sale -- excuse me. Their engagement letter
7 incorporates a sale transaction fee that incorporates
8 escalators incentivizing Houlihan's maximization value for
9 the estates. That's pretty common in most investment banking
10 engagement letters.

11 If certain aggregate thresholds are met
12 incremental fees can be earned. I understand that Houlihan
13 Lokey will earn for aggregate gross consideration of up to
14 \$150 million dollars. It will be a fee of \$1.7 million
15 dollars, so that's sort of the floor.

16 If the aggregate gross consideration is between
17 \$150 and \$170 million dollars, then it will be \$1.7 million,
18 plus a three percent on that incremental increase.

19 And then it continues to sort of ramp up from
20 there; a 170 to 200 would be a four percent incremental
21 increase. And anything above two hundred million, excuse me,
22 will be a five percent of the aggregate gross consideration.

23 THE COURT: Okay. And is there a monthly and is
24 there any crediting?

25 MR. SCHLAUCH: Just checking the application.

1 THE COURT: What docket item are we are, anybody
2 know?

3 MR. SCHLAUCH: This is docket item 105. This is
4 the application.

5 THE COURT: I'm sorry. Which tab number are we
6 on?

7 MR. SCHLAUCH: Oh, it's item number 21. Sorry, I
8 know there are many volumes.

9 Yes, there is a monthly fee structure of \$125,000
10 dollars per month. And there are other fees, restructuring
11 transaction fee, financing transaction fee, other amounts
12 owed during a termination tail fee. And those are all set
13 forth on pages 7 through 9 of Houlihan's retention
14 application.

15 Unless Your Honor has any questions or concerns,
16 we respectfully request the order be entered.

17 THE COURT: Okay. And what was the resolution of
18 whatever objections were filed?

19 MR. SCHLAUCH: Yes.

20 (Participants conferring)

21 MR. SCHLAUCH: I'm sorry, Your Honor. Counsel for
22 committee caught my ear and I didn't hear your question. To
23 walk through the --

24 THE COURT: I asked what the resolution of
25 outstanding issues were.

1 MR. SCHLAUCH: Yes. I apologize, Your Honor. I
2 misplaced my blackline.

3 The UST had asked for some clarifying language in
4 paragraph 4 and 5, which Houlihan was comfortable accepting.
5 There was some additional changes to the United Artist
6 language that the UST requested. That is in paragraph 7(b) of
7 the order.

8 And then in paragraph 10 and 11, these are new
9 paragraphs. Paragraph 10 is related to Asarco, so that is --
10 they're not going to get fees on fees for defending their fee
11 applications.

12 THE COURT: Okay.

13 MR. SCHLAUCH: And 11 has to deal with if the case
14 were to convert that the Chapter 7 trustee would not be bound
15 to sort of payment of certain fees by Houlihan Lokey.

16 THE COURT: Okay. Anyone wish to be heard with
17 respect to Houlihan Lokey's application?

18 MR. INDYKE: Your Honor, Jay Indyke for the
19 committee again.

20 As part of the terms of the settlement that we
21 reached on the financing, as I stated this morning, our
22 withdrawal of, our limited objection to the Houlihan
23 retention was part of that term sheet; however, Your Honor,
24 hasn't proved that yet. So, we will withdraw our objection
25 and are fine with the order as long as the financing order

1 with our terms is approved.

2 THE COURT: Okay.

3 MR. INDYKE: Thank you.

4 THE COURT: Okay. So, I'll hold this and it will
5 give me a chance to review it as well.

6 MR. SCHLAUCH: Thank you, Your Honor.

7 THE COURT: But my understanding then is that
8 assuming the financing is approved, then there are no
9 objections?

10 MR. SCHLAUCH: Your Honor, we do have some more
11 housekeeping items today. We have the debtors' order
12 granting leave to file the late reply, and I know the notes
13 also have a similar motion or order, excuse me. I have the
14 form of the debtors' order I can hand up.

15 So, unless Your Honor has any questions, ask you
16 to enter the order.

17 THE COURT: And that's signed.

18 MR. SCHLAUCH: Thank you, Your Honor. And I
19 believe the committee has one item as well.

20 THE COURT: That's good.

21 MS. GOOD: Good afternoon, Your Honor, Katie Good
22 on behalf of the committee. We do have one item on the
23 agenda, number 19, which was our motion to file under seal
24 our objection to the DIP.

25 The objections are due at the hearing today. We

1 did receive informal comments from the office of the United
2 States Trustee. And after discussions with the U.S. Trustee
3 and with the debtors, I'm able to report that we can file a
4 revised redacted version. It removes certain of the
5 redactions, and I can hand up a copy to Your Honor that is
6 tabbed in highlights in an unredacted form what we will file,
7 what redactions have been removed essentially.

8 THE COURT: Okay. So, this is now agreed?

9 MS. GOOD: Yes. And we will file that after the
10 hearing today as objections were due at the hearing. We
11 didn't file the revised redacted version in advance. That as
12 soon as this hearing is over and, assuming there are no other
13 objections from any parties, we will file this revised
14 redacted version.

15 THE COURT: Okay. So, the highlighting is what's
16 going to now --

17 MS. GOOD: Be on the docket.

18 THE COURT: -- be on the docket. Okay.

19 Does anyone wish to be heard with respect to the
20 committee's motion?

21 (No verbal motion)

22 THE COURT: I hear no one. I will sign the order.

23 MS. GOOD: May I approach?

24 THE COURT: Yes.

25 MS. GOOD: Thank you, Your Honor.

1 MR. ROBINSON: Your Honor.

2 THE COURT: Mr. Robinson.

3 MR. ROBINSON: Colin Robinson, Pachulski Stang
4 Ziehl & Jones on behalf of the noteholders.

5 Your Honor, as debtors' counsel indicated, we
6 filed a leave to file a reply. I don't have a proposed order
7 with me. I don't believe there are any objections, Your
8 Honor, unless Your Honor has one. We'll submit a certificate
9 --

10 THE COURT: Do I have to do that?

11 (Laughter)

12 THE COURT: Can I retroactively --

13 MR. ROBINSON: I'll submit a certificate of --

14 THE COURT: -- deny all of those.

15 MR. ROBINSON: -- certificate of no objection, Your
16 Honor, and we'll send over the order.

17 THE COURT: That's fine.

18 MR. ROBINSON: Thanks, Your Honor.

19 THE COURT: Anything else?

20 (No verbal response)

21 THE COURT: Okay. I will have Ms. Johnson reach
22 out to let parties know when I'm going to rule.

23 MR. COLLINS: Your Honor, would that be a
24 telephonic hearing or would you like local counsel, at least,
25 to be in court?

1 THE COURT: It might be helpful to have local
2 people here, if you can be here. If you can't, I understand
3 that because it's going to be on tight notice. And I do need
4 to check with Mrs. Johnson. And, certainly, people from out
5 of town can be on the phone. But I'll have her reach out and
6 let parties know what's going to work.

7 This is Wednesday, isn't it?

8 UNIDENTIFIED SPEAKER: Yes.

9 THE COURT: Okay.

10 MR. COLLINS: Okay.

11 THE COURT: I don't anticipate it tomorrow, just
12 looking at my schedule. But I'll have her reach out.

13 MR. COLLINS: Thank you, Your Honor. Thank you
14 for all your time today.

15 THE COURT: Thank you.

16 We're adjourned.

17 (Proceedings conclude at 4:54 p.m.)

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21 CERTIFICATE

22

23 I certify that the foregoing is a correct transcript from the
24 electronic sound recording of the proceedings in the above-
25 entitled matter.

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

IN RE:) Case No. 15-10541 (BLS)
) Chapter 11
THE STANDARD REGISTER COMPANY,)
INC., et al.,)
)
Debtors.) Courtroom No. 1
) 824 Market Street
) Wilmington, Delaware 19801
)
) April 13, 2015
) 10:00 A.M.

TRANSCRIPT OF HEARING
BEFORE HONORABLE BRENDAN L. SHANNON
UNITED STATES BANKRUPTCY JUDGE

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25

INDEX

Page

NOTICE OF AGENDA MATTERS:

For the Debtors, by Mr. Rosenthal	4
For Creditors Committee, by Ms. Levine	14
For U.S. Trustee, by Mr. Kenney	26
For the Debtors, by Mr. Lutz	36
For the Creditors Committee, by Mr. Bellmann	42
For Silverpoint, by Mr. Meisler	93
For the Debtors, by Mr. Graves	110
For the Debtors, by Mr. Newman	114

<u>WITNESS FOR THE</u>	<u>Direct</u>	<u>Cross</u>	<u>Redirect</u>	<u>Recross</u>	<u>Further Redirect</u>
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DEBTORS:

Andrew Torgove	38	39			
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<u>WITNESS FOR THE</u>	<u>Direct</u>	<u>Cross</u>	<u>Redirect</u>	<u>Recross</u>	<u>Further Redirect</u>
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COMMITTEE:

David MacGreevey	48	57	61	62	63
Leon Szlezinger		68	77	78	

EXHIBITS:

Torgove & Carmody Affidavits	38
DIP Amendment	

1 THE CLERK: All rise.

2 THE COURT: Please be seated. Good morning. Mr.
3 Rosenthal.

4 MR. ROSENTHAL: These are always too high for me,
5 Your Honor. I need to get taller. Good morning, Your Honor.

6 THE COURT: Good morning.

7 MR. ROSENTHAL: Michael Rosenthal on behalf of the
8 Debtors. I'm from Gibson Dunn & Crutcher. And in the
9 Courtroom with me today since this is the first time that
10 some of the officers have appeared, it is Kevin Carmody from
11 McKinsey who is the Debtors' chief restructuring officer.

12 THE COURT: Welcome.

13 MR. ROSENTHAL: And Andrew Torgove of Lazard who is
14 the Debtors' chief investment banker.

15 THE COURT: Welcome.

16 MR. ROSENTHAL: Also with me are my colleagues Brian
17 Lutz, Jeremy Graves and Sam Newman.

18 THE COURT: Very good.

19 MR. ROSENTHAL: We have a full docket this morning,
20 Your Honor, so we appreciate your time. As an overview, I'd
21 like to make a recommendation about how to handle the
22 hearing. We'd like to take up the most contentious issues
23 first, the sale and financing issues. And we'd like to take
24 them up at the same time because we think that there will be
25 the same witnesses on these.

1 THE COURT: A lot of the points travel together.

2 MR. ROSENTHAL: Correct. Then after we are
3 completed, have completed the sale and DIP hearings and we'll
4 present a few final orders on first day motions and finally
5 some argument on lift stay motion.

6 There have been a number of CNO's filed.

7 THE COURT: I think that I've signed all the orders
8 that relate to the CNO's and they should be on the docket or
9 they should be headed for the docket this morning. If
10 they're not there today then give me a call. But I don't
11 have any issues with the matters that were presented under
12 CNO.

13 MR. ROSENTHAL: Right; thank you, Your Honor.
14 Returning to the sale of financing issues let me give you a
15 little background and then I'm going to turn it over to my
16 partner Mr. Lutz to introduce some evidence.

17 As you know, the Debtors engaged Lazard, McKinsey
18 and Gibson Dunn to evaluate their restructuring alternatives
19 prior to the filing. They determined they didn't have
20 sufficient financial wherewithal to effectuate an internal
21 reorganization even if they could manage to accomplish a debt
22 to equity conversion or trying to use the cram down
23 provisions of Chapter 11. They were simply going to run out
24 of cash and couldn't pay the PBGC the annual amounts due
25 them.

1 So they engaged in a targeted or an extensive pre-
2 filing marketing and diligence effort. Now when we were the
3 first time I appeared before you, the Court observed that you
4 didn't think that there had been much marketing done. I
5 think the declarations will show Your Honor that there was a
6 pretty extensive effort. It was targeted. And it was
7 targeted to what the Debtors thought was the most likely
8 buyer and we got near deal right to the break and we didn't
9 get a deal.

10 When that buyer fell through the Debtors began in
11 earnest completing negotiations with Silver Point because
12 they concluded that it would be incredibly destabilizing to a
13 business to enter Chapter 11 in a free fall. They needed to
14 give their customers and their vendors and their employees
15 the comfort of knowing that there was an exit from this case
16 and it wasn't going to languish forever and ever. That's one
17 of the reasons, Your Honor, that the Debtors negotiated not
18 just the stalking horse APA but an amply sized debtor-in-
19 possession financing.

20 There has been some discussion in the papers the
21 Court will know about how perhaps this financing is
22 oversized. I suggest to the Court it is definitely not
23 oversized. It was sized based on a worst case situation that
24 vendors would put the Debtor on COD. The fact that we could
25 headline to the vendors and the customers that we had ample

1 financing during the case is actually what I think has led;
2 at least, in the early phases of the case to a reduced use of
3 cash. But we expect a lot of that to be taken up as we make
4 the critical vendor payments that the Court has already
5 approved.

6 Both of these items gave a lot of comfort, we think,
7 to the customers and our vendors. And that's why we've been
8 able, for the most part, to keep our business stabilized.
9 Everyone has an expectation that this June auction will occur
10 on time. Your Honor, just a little bit about each of the DIP
11 and sale motion.

12 On the DIP, I think the declarations and the memos
13 demonstrate we need financing to continue operations. And
14 the reality is that the DIP lenders at the table here are the
15 only game in town. Do we have the most ideal DIP that's ever
16 been negotiated by a Debtor? No. Do we have the most ideal
17 terms? Could we have, would we have been happy with
18 additional concessions? Absolutely. But we didn't have that
19 option.

20 What we had was one party at the table. We
21 approached pre-filing, six or seven lenders about whether
22 they would be willing to extend debtor-in-possession
23 financing. No lender was willing to be a party to a priming
24 fight. And no lender was willing to extend financing behind
25 \$315 million dollars of debt.

1 So we did what Debtors in our situation always do.
2 They negotiate as hard as they can with as much leverage as
3 they have, which sometimes isn't much, and you arrive at the
4 best deal that you can. And our best deal in this case
5 included not just the financing package, but which was a
6 bridge, but it was a bridge to an exit which is the stalking
7 horse APA.

8 With respect to the sale process, we think the
9 issues are very straightforward there as well. We have a
10 stalking horse bid. Again, it was the only party that we
11 were able to bring to the table before we filed. The bid is
12 for approximately \$273 million dollars when you take into
13 consideration cash, assumption of liabilities, and credit bid
14 rights.

15 And, again, if we had been able to get there with
16 someone else, perhaps we would have been standing before you
17 with a third party buyer instead of the secured lenders as
18 the buyer. But we were unable to do that. So there have
19 been two basic objections that have been raised. One is the
20 timeline and the second is that the business would be, that a
21 longer sale process is in the best interest.

22 We propose a 90 day timeline, Your Honor, because we
23 think that's more than adequate. Our investment banker at
24 Lazard believes that 90 days is more than enough time to
25 conduct a robust auction; particularly given that we started

1 this process before filing. We have a complete data room.
2 We have we think already in the data room and signed NDA's
3 with the most likely candidates. The Jeffries gave us a few
4 additional names. The Lazard team is tracking that down.

5 In fact, Your Honor, we think that this timeline
6 which is basically from filing about 90 days to auction and
7 95 days; 90 days to bid and 94, 95 days to auction is
8 significantly more than what has been the case in Delaware
9 over the past three years. We sort of looked at some of the
10 cases. We looked at 75 cases.

11 THE COURT: I know you've got a chart.

12 MR. ROSENTHAL: We found the average time from the
13 petition date the sale was less than 60 days.

14 THE COURT: [inaudible].

15 MR. ROSENTHAL: There you go. With respect to
16 whether an extended timeframe would be helpful or maximize
17 value, you will hear from Mr. Carmody that, in fact, a delay
18 in the sale -- you'll hear from Mr. Torgove that a delay in
19 the sale process is not necessary to induce the appropriate
20 buyers. You'll hear from Mr. Carmody that a delay in the
21 sale process, in fact, will damage the business because of
22 the customer's expectation that this is going to come to an
23 end. And because of the fact that every single day we spend
24 in bankruptcy more and more customers leave; more and more
25 vendors have questions; more and more employees leave.

1 That's one of the reasons you're going to see,
2 incidentally, any day now a management incentive plan motion
3 because we are concerned some of our employees have left and
4 some of our employees are being poached as we stand here.

5 THE COURT: Well there are two elements to the
6 Committee objection and, frankly, the other players as well,
7 but particularly the Committee. The first is obviously the
8 timeline and the sufficiency of the marketing and sale
9 process. And the second were specific elements of the
10 proposal that include a breakup fee or a secured lender that
11 include a substantial expense reimbursement, the mechanics,
12 who ought to credit bid. So there are obviously -- I mean I
13 understand the timeline issues, but there are those elements
14 as well. And I expect the Debtors' presentation will deal
15 with them as well.

16 MR. ROSENTHAL: It will, Your Honor, that's what I'm
17 getting to next. So another significant part of the attack
18 are the bid protections. And here, again, the Debtors find
19 themselves in a not unusual situation where they have a
20 bidder at the table. They want to keep the bidder at the
21 table. They want to induce that bidder to put a stalking
22 horse bid on the table. And the bidder wants our
23 protections.

24 We attempted to the extent that we had leverage to
25 do so. We attempted to reduce the breakup fee request and to

1 reduce the expense reimbursement. What you see is the result
2 of those negotiations. And what I would caution the Court is
3 that it's very easy to say that breakup fee should be less
4 and non-existent. Expense reimbursement should be less or
5 non-existent. But if that causes the stalking horse to walk
6 we're back to a freefall and back to a liquidation. And the
7 stalking horse sale, the sales procedure order is tied to the
8 DIP until we run out of money.

9 One of the things that has come up throughout the
10 papers, Your Honor, is have the Debtors and their management
11 team comply with their fiduciary duties. And we have talked
12 about what the standard is. We've talked about business
13 judgment. The Committee has talked about inherent fairness.
14 Frankly, I think this is a red herring. I don't care what
15 the standard is. I think that the company has complied with
16 that standard.

17 The company's board is not an interested board --

18 THE COURT: Yeah I think and I will hear from the
19 Committee on this. But I don't necessarily regard the
20 fiduciary duty element of this; at least, in the context that
21 we're in to be a productive inquiry for a couple of reasons.
22 First, as a practical matter the application of fiduciary
23 duties and the business judgment rule at a minimum occupy a
24 very different functional role than they do three blocks down
25 the street at the Chancery.

1 So when a Debtor proposes in a Bankruptcy Court I'm
2 not certain if that has the same in a typical scenario
3 implication of fiduciary duties as it does outside of
4 bankruptcy. It is a complicated inquiry and I think it
5 unnecessarily complicates the discussion that we're in about
6 whether or not this is consistent with fiduciary duties or
7 not. The issue is more of a bankruptcy question I think than
8 a traditional corporate governance and corporate law
9 question, and I think that; so I'll be happy to hear from the
10 Committee on that.

11 I've had this inquiry, this concept before, but you
12 know one of the challenges that I have with at least some of
13 this, and you can point to prepetition conduct and we can
14 debate about whether or not that in a different case or in a
15 typical case might implicate fiduciary duties. But in a case
16 such as this for example if the Debtor were to make a
17 proposal and come in and say Judge we want you to approve
18 this sale, this financing arrangement, etcetera, one or two
19 things will happen.

20 I will approve it by final order reflecting that I
21 found that it is consistent with their best business
22 judgment, etcetera; end of inquiry about fiduciary duties,
23 absent an appeal or I will deny it. And while the denial
24 might -- I'm not sure that my denial on a full record means
25 that the party that asked for something and it got denied has

1 breached their fiduciary duties. So I don't want to spend
2 too much time on this, but I have seen that.

3 I understand the issue and there may be nuances
4 where it has particular application, but as a general
5 proposition I understand the dynamic as you've described it.
6 It's not unfamiliar to, you know, your colleagues on the
7 other side for the Committee. It's not, you know, unfamiliar
8 to the lender, etcetera. I'm not certain that this is a
9 fiduciary duty issue; at least at this stage.

10 But, again, I'm happy to hear from the Committee on
11 that point. But most of the issues, I think, are the
12 traditional concepts that we're discussing now.

13 MR. ROSENTHAL: Thank you, Your Honor. I mean I
14 think the reality is, is that the company was presented, was
15 in financial straits and presented with the option of filing
16 a freefall liquidating or filing with a stalking horse. And
17 this is the stalking horse we had and that stalking horse was
18 willing to bring the other lenders along with DIP financing
19 to get to the end of the game.

20 Your Honor, with that background we'd like to put on
21 our case in chief and I'd like to turn it over to my partner
22 Brian Lutz.

23 THE COURT: Ms. Levine, did you wish to be heard?

24 MS. LEVINE: Your Honor, can we open a little
25 [indiscernible]?

1 THE COURT: Briefly, yes.

2 MS. LEVINE: Your Honor, just to set the table a
3 little bit also and it may streamline the testimony. The
4 Committee's concern is that we believe the DIP is
5 inappropriate and obviously Your Honor has the right to
6 either approve it or not approve it. But we're going to talk
7 to you a little bit about why we think it shouldn't be
8 approved under its present terms.

9 We think the issues with regard to the sale may be a
10 little bit different. Your Honor, has the right to approve
11 it or not approve it, but I think Your Honor also has the
12 right to modify it if you deem it appropriate and approve it
13 as modified. And one of the things we'll note and one of the
14 things you'll hear from us is that in both the DIP and the
15 sale the outside deadline is actually September 8th. So there
16 is room here to potentially run a fair more open process.

17 With regard to the specifics that we were talking
18 about with regard to the DIP, Your Honor, the Committee's
19 primary concern is that it appears to be granting liens on
20 assets that were not previously encumbered. We're looking at
21 the avoidance actions, the foreign stock, and the Mexican
22 assets. If under the existing sale process which is what we
23 seem to have today, there's no recovery for general unsecured
24 creditors, then unsecured creditors through this Chapter 11
25 process are actually being put in a worse position not even

1 a neutral position in order to let this DIP and the sale
2 process go forward.

3 In addition to that, Your Honor, the marshalling
4 arguments seem to be a red herring because what that does is
5 that lets the secured creditor take away what we argued
6 should be unencumbered assets to pay those first with regard
7 to the DIP.

8 THE COURT: In a liquidation scenario or otherwise.

9 MS. LEVINE: No it's in a; in other words they will
10 -- the way we read the papers they're going to use the
11 unencumbered assets as collateral for the DIP and then credit
12 bid the DIP and take those assets and take that value. And
13 then if you read the assets purchase agreement, Your Honor,
14 there's a cap on 503(b)(9) claims, lease claims, cure claims,
15 and our administration, and I'll get to the Committee
16 professionals in a minute which is a separate issue but tied
17 into this. So it looks like we're not only giving nothing to
18 unsecured creditors, but we're creating a scenario that
19 likely creates an administratively insolvent estate.

20 So if we had done this out of Court we'd have
21 foreclosures and it would be whatever it would be. But by
22 taking it to bankruptcy we're not maximizing asset values for
23 the benefit of the parties and paying the cost of that
24 maximizing. What we're doing here is giving nothing to the
25 general unsecured creditors and potentially creating a worst

1 administrative insolvency than we had on day one when the
2 petition was filed.

3 Your Honor, we would also note that the DIP order
4 prevents a credit bid what we would call [indiscernible]
5 protections. In other words, if in fact they credit bid we
6 lose the challenge period. So we heard Your Honor with
7 regard to the DNO and the breach of fiduciary duty, equitable
8 subordination and all those things, and we agree that that's
9 not necessarily an issue for today. The Committee is doing
10 its investigation. It's looking at what it would normally
11 look at in connection with its challenge rights. But we
12 don't think that procedurally any of that should go away
13 today.

14 And we think it's interesting that the sale
15 objection deadline for the Silver Point bid is May 21 when
16 currently even if we don't ask for any extensions, May 23 is
17 the challenge deadline. So, in essence, they've already
18 shortened our challenge by two days. In addition to that
19 they haven't granted the Committee standing under either of
20 the order which means that basically we should be filing
21 something in a week or so if we're going to have it heard
22 with an ample opportunity for Your Honor to actually consider
23 it.

24 In addition to that, there's no tolling of the
25 challenge period while a standing motion is pending. In

1 addition to that, June 10 is the deadline for sale objections
2 relating to things that happened at the auction and other
3 bids. But it's unclear to us why June 10 shouldn't just be
4 the Committee's deadline as well with regard to the Silver
5 Point bid. A challenge is a default under the DIP and it
6 also triggers the right for Civil Court to withdraw the APA
7 or the stalking horse bid.

8 In addition to that, Your Honor, the carve out is a
9 little bit illusory because it does come junior to the ABL
10 loan. And we think it's interesting also that just last
11 night the ABL loan got two points more expensive.

12 THE COURT: What?

13 MS. LEVINE: The asset base DIP loan apparently
14 there was a typo it said in the papers so the filing last
15 night increased the interest rate on the asset base loan by
16 two points.

17 THE COURT: Is that in the Debtors' reply?

18 MS. LEVINE: I believe it was, Your Honor.

19 THE COURT: Okay. I didn't see that in the reply.
20 I read the reply this morning. Where is that?

21 MR. ROSENTHAL: No, Your Honor, I don't think it was
22 in the reply. This was something that was raised to us last,
23 what's today Monday, Wednesday or Thursday that the intent
24 had been to have the default rate of interest for the ABL
25 loan and it was a two point differential from where it was;

1 two point differential. The Debtors pushed back on it.
2 There was one reference in a long series of documents related
3 to the DIP that had a reference that maybe it was two points
4 higher. But I think we would have had an argument with the
5 Court, but our dilemma was we needed an amendment to the DIP
6 loan on Friday that there's a sale hearing was supposed; the
7 sale procedures order was supposed to have been entered by
8 the 10th.

9 So we needed an amendment. And we thought that even
10 if we didn't need that amendment at some point, we were going
11 to need amendments. And we were going to get to have to give
12 this two points. There was a legitimate dispute about what
13 the parties intended. So rather than face a default which
14 would have to have been, you know, which people would have
15 found out about and it would have created negative
16 repercussions, we did agree to an amendment which increased
17 the ABL interest rate by two percent.

18 THE COURT: I understand. Okay thank you. Ms.
19 Levine.

20 MS. LEVINE: Your Honor, the cap on investigating on
21 leads of \$25,000.00 seems a little bit slight in this case.
22 The history is convoluted; even the hearings are convoluted.

23 Your Honor, with regard to the budgeted amounts for
24 the Committee's professionals even aside from the fact that
25 the carve out seems to come after the asset base loan, the

1 proposed amount is a \$100,000.00 for Committee counsel and
2 Delaware co-counsel, a \$100,000.00 a month for both the
3 Committee's investment banker and financial advisor. Whereas
4 if you take a look at the Debtors' numbers McKinsey is at
5 \$750 a month, Gibson Dunn Crutcher \$750 to a million, Lazard
6 is a \$110 a month with a likely backend fee of about \$5
7 million; take it or leave it. The Debtors' corporate counsel
8 is at a \$125 a month and the Debtors' Delaware counsel is at
9 a \$150 a month and that's over and above \$3.2 million dollars
10 paid the week before the filing for retainers to these
11 various professionals. And even Silver Point's
12 professionals, Your Honor, were paid legal fees of \$1.6
13 million or paid legal fees of \$1.6 million in a budget for
14 May, June and July and received \$1.5 million during the 75
15 days prior to the bankruptcy with a million of that coming
16 right before the bankruptcy filing.

17 Other things, Your Honor, they give us news of an
18 amendment, but they don't give us an opportunity to be heard
19 or to toll the amendment while Your Honor considers it if
20 there is an objection. We don't get simultaneous notice of
21 notices that are required to be given to the lenders and the
22 Debtors. And the variance is overly restrictive. For most
23 of the variances in the DIP credit agreement, it appears that
24 the variance is 10% which if you do the chart is within
25 market. But for two which are a little bit confusing to us,

1 the variance is 5%. And the two where the variance is 5% is
2 postage and payroll.

3 So what the Debtor is really saying or what the DIP
4 lender is really saying is if you do really well we're going
5 to [indiscernible] a default which in our mind causes us
6 concern about suppressing value.

7 THE COURT: Your point with me that if the business
8 is going toll tilt and they're paying overtime and --

9 MS. LEVINE: It's more than that, Your Honor. In
10 the payroll line is commission. So if they're selling then
11 they're going to blow the budget. And the other thing is
12 postage. So if they're shipping then they're going to blow
13 the budget. And it's ironic because if they're selling then
14 they should have ample more receivables to cover that. And
15 if they're shipping postage, Your Honor, is actually a pass
16 through. So it's really nothing more than a timing issue.

17 With regard to just a couple more issues on the
18 sale. The breakup fee of 2% is \$5.14 million. Even the
19 Debtors in their opening have referred this is sort of a
20 protective credit bid, so they're going to do this with or
21 without the breakup fee and with or without the expense
22 reimbursement. Also it's unclear to us how much of the
23 expense reimbursement may be double counted in the \$1.6
24 million that Silver Point received in the three months prior
25 to the bankruptcy filing.

1 The cash deposit required by Silver Point is \$2
2 million. Other qualified bids are required to bid 10% which
3 brings them up to \$28.5 million. We think substantially less
4 than that is good faith enough to open up the bidding
5 process. We also think they can drop the over bids from \$500
6 to \$275. That's really going to make a, if it's going to
7 make a difference. They also require that competing bids
8 designate all of the executory contracts and leases to be
9 assumed and rejected. But the stalking horse bid currently
10 doesn't have those designations.

11 The backup bidders are not required to stay in place
12 pending a closing which seems a little bit unusual. With
13 regard to the timeline we discussed it briefly, but we would
14 ask for 60 days to the extent Your Honor approves this for
15 everything. Including switching the objection to the
16 Committee to object to the bid to the same day everybody else
17 is objecting. So take May 21 and make it two days before the
18 sale hearing. Take the June 1 bid deadline and make it July
19 31. Take the June 4 sale hearing and push it to August 3.
20 Take the June 8 auction and push it to August 7th. And then
21 take the June 10 objection deadline and put it two days prior
22 to the sale hearing. And then take the auction and perhaps
23 push it to August 11th which would allow the sale order to get
24 entered by August 14th and allow a closing well in advance of
25 the September [indiscernible] date under both the DIP and the

1 existing asset purchase agreement.

2 Your Honor, it's unclear from the bid procedures
3 order, but we would obviously also ask that the Committee and
4 its members and their professionals be permitted to attend
5 the auction. We don't really want to debate whether we're
6 targeted or not targeted prepetition marketing process was
7 appropriate or not appropriate. The fact is we understand
8 that the Debtor did try hard to get to closure with one
9 bidder. It didn't work.

10 We think that we need to run a robust sale process
11 post-bankruptcy so we can bring other people to the table.
12 And we've already gotten calls as we indicated at the first
13 day of the case, Your Honor, from several other bidders who
14 were interested in getting into the process. There was no
15 teaser or SIM until after the filing of the case. And the
16 business plan, Your Honor, as we understand it is still not
17 complete which is very important; particularly, for a
18 financial bearer to understand what the numbers are.

19 Importantly, similar with the DIP we don't believe
20 that the credit bid should be permitted to pay down
21 unencumbered assets. Again, we want a reservation of rights
22 with regard to all the Radnor issues. We think it's
23 interesting that in the form of order --

24 THE COURT: Let me ask you a question. I've been
25 trying to noodle through on the mechanics of that issue your

1 point is that Silver Point as of the petition date or as of
2 today does not have liens on certain assets there or
3 otherwise unencumbered and, therefore, presumably available
4 to unsecured creditors for distribution. The DIP
5 contemplates a collateral package that would be on all
6 existing collateral as well as new collateral, previously
7 unencumbered.

8 Now it's not unusual that a DIP be included for
9 purposes of a credit bid. Can you walk me through because I
10 think that this implicates the marshalling argument.

11 MS. LEVINE: Yes that's exactly correct, Your Honor.
12 So our concern is I'll give you a simple example. Assets
13 here are covered by the prepetition liens and assets here are
14 not. So if we get a DIP which the Committee is positing is
15 not necessarily benefitting unsecured creditors. They now
16 have a lien on this group of assets and this group of assets.
17 If they credit bid they're taking all the assets.

18 Our argument is that they should only get a post-
19 petition lien on the prepetition collateral package because
20 they're not really bidding anything to the unsecured
21 creditors.

22 THE COURT: You'd agree with me though that's not a
23 typical DIP financing arrangement that somebody takes a lien
24 on the assets that they --

25 MS. LEVINE: Correct, Your Honor, but that's not,

1 but in a typical DIP financing arrangement even in a case
2 where there's not a substantial recovery to unsecured
3 creditors, there is generally some benefit to the unsecured
4 creditors by virtue of that DIP financing. Here, we're
5 leaving behind probably as far as we can tell it's at least
6 \$400 million dollars in claims. In addition to that, we're
7 potentially creating an administratively insolvent estate.

8 And, Your Honor, we would submit that based upon the
9 form of order that was submitted last night it didn't address
10 any of the Committee's concerns. But it does allow the asset
11 base lender now to credit bid at the auction which wasn't
12 previously part of their rights and to announce at the
13 auction. So what that says is they too like us are afraid
14 that Silver Point has the absolute right to call in event of
15 default under the DIP and withdraw its bid.

16 The other thing we found unusual, Your Honor, is
17 there is some environmental issues here. We're not sure
18 whether or to what extent they're material. But there seems
19 to be an express prohibition against any bidder performing a
20 phase two and we're not exactly sure why that would be
21 something that we would want, if we want to encourage people
22 to do whatever they need to do to bid.

23 Your Honor, so just briefly in conclusion we think
24 that -- we understand that Your Honor probably doesn't have
25 the ability to modify the DIP so, therefore, we are asking

1 that it be denied. We think that Your Honor does have the
2 ability to modify the sale procedures. To the extent you
3 don't think it's appropriate to deny, then we would ask that
4 you modify them. What the Committee really wants here is a
5 fair and open process and an opportunity not only to promote
6 the highest and best offer for the assets, but to conduct its
7 investigation to the extent appropriate, bring appropriate
8 causes of action, and appropriate time. Thank you.

9 THE COURT: Mr. Kenney. Actually before I hear from
10 Mr. Kenney, Mr. Rosenthal, can you just give me a little bit
11 of context on one issue -- and this will only take a second -
12 - between the proposed timeline the Debtors have for an
13 auction and the sale hearing and the closing date. Can you
14 give me some reason why that process, why there's that
15 anticipated [indiscernible] --

16 MR. ROSENTHAL: I think the thought, Your Honor, if
17 a third party bidder comes in I think the thought is that if
18 a third party bidder comes in, it might take a little longer
19 to get all the documents finalized and everything done. And
20 in addition we've got an HSR period that will not have run.

21 THE COURT: Okay.

22 MR. ROSENTHAL: So you take those two -- can I take
23 a couple things off the table because I wish Ms. Levine would
24 have called me because some of these things --

25 THE COURT: Why don't we do this. Mr. Kenney can

1 infer. Hang on just a second. I've just been advised that
2 we have a problem with CourtCall. We're going to take a 60
3 second break and we'll CourtCall back in. And then, Mr.
4 Kenney, we'll begin with you. I apologize for the
5 interruption. Stand in recess.

6 [10:36:56 - 10:40:38]

7 THE CLERK: All rise.

8 THE COURT: Please be seated. Mr. Kenney, good
9 morning.

10 MR. KENNEY: Good morning, Your Honor, Mark Kenney
11 for the United States Trustee. Your Honor, my objection on
12 the bidding procedures [indiscernible] Committees I'm solely
13 looking at the breakup fee and the expense reimbursement.
14 And I think this is something that they touched on a little
15 bit in that the whole concept of a breakup fee is that's for
16 someone who absolutely needs that as an inducement to get
17 them to the table to sign a stalking horse agreement or
18 somebody to put the Debtor in a sales mode.

19 And what we have here essentially, Your Honor, is a
20 friendly foreclosure. And Silver Point is going to foreclose
21 on these assets whether it's friendly or whether it's
22 adversarial. And coming into the Bankruptcy Court they're
23 saving a lot of money instead of having to go into a number
24 of different counties and a number of different states where
25 they could have hundreds of separate asset foreclosure

1 actions, so this saves them a lot of money. They don't need
2 a breakup fee to induce them to come to the table and to sign
3 an agreement.

4 The Debtors have --

5 THE COURT: The Committee has made certain
6 observations with respect to whether Silver Point is either a
7 statutory or a non-statutory insider. Do I need to get to
8 that inquiry or is the question more does this particular
9 bidder need the incentive of a breakup fee?

10 MR. KENNEY: Your Honor, I think anytime you have a
11 lender, a breakup fee to the lender is suspect if they are an
12 insider. And I know there seems to be an open question on
13 that. And I didn't go there because from what I saw in the
14 first day papers they weren't. But the Committee has brought
15 up they looked at the SEC filings. And I don't know if
16 Silver Point is an insider. I would say that if they are an
17 insider we don't even need to consider whether it's necessary
18 to induce them. I think the breakup fee should come off the
19 table immediately if they're an insider.

20 THE COURT: From your office's point of view, is
21 there a difference as a matter of law or as a practical
22 matter between a breakup fee and an expense reimbursement?

23 MR. KENNEY: Your Honor, a very limited expense
24 reimbursement is something we might look at a little bit
25 differently because a breakup fee is something that it's

1 supposedly to induce and to come to the table in the first
2 place. An expense reimbursement is something that is
3 supposed to be for specific documents and expenses incurred
4 in getting to a transaction. Of course, here, as a secured
5 lender who is looking at having to take possession of its
6 collateral anyway, I think they're incurring a lot of those
7 costs anyway.

8 And I think what's missing is and I understand the
9 Debtors negotiate the best that they can. They're not
10 exactly in a position holding the upper hand. You know the
11 secured creditor basically is holding all the cards and
12 saying you know we're going to liquidate our collateral
13 whether it's friendly or not. But it seems to me, Your
14 Honor, once they establish a floor price, the floor price is
15 basically the amount of money they're going to need to let go
16 of their collateral and let some other party take it away
17 from them.

18 And I think that in most cases, Your Honor, the
19 secured creditor wants other people to come in. If somebody
20 comes in with more money, they're going to do something --
21 well for lack of a better term, Your Honor, I think the word
22 is they're going to salivate. You know they're going to
23 welcome any higher bids. And, therefore, they don't need the
24 inducement of a breakup fee to get them to the table. And
25 they don't need a breakup fee to consult them for the risk of

1 not getting their collateral. If somebody else makes a bid
2 that they don't like they can simply bid more on their credit
3 bid up to the point that they cover their debt in full.

4 I think if there's some risk to them if they're not
5 going to cover their debt in full, they should be happy to do
6 it. If we have an estate that might be solvent, again
7 they're already in there. You know their inducement is to
8 make sure the assets don't go for too little money. So
9 essentially all that their stalking horse bid does is kind of
10 ring fence the assets and say we're not going to let them go
11 for anything less than this amount.

12 It seems to me once you get above that they have
13 every reason in the world to want other people to come in and
14 bid on them. And even the expense reimbursement, Your Honor,
15 I said at 20% of what they're seeking is probably generous
16 because every dollar of expense reimbursement that they're
17 requiring somebody to reserve for is an additional dollar
18 somebody has to bid for. If you made somebody put up \$4
19 million dollars as an expense reimbursement and then it turns
20 out that their reimbursable expenses that they haven't
21 already extracted from the Debtor elsewhere are only a
22 \$100,000.00, then you may have discouraged people and kept
23 them away from the bidding in the first place.

24 And the goal here is to attract bidders not to repel
25 them. And the difficulty is that when you set it up with a

1 breakup fee to a stalking horse who is already the lender and
2 has every incentive to want other people to bid and then
3 layer onto that an expense reimbursement of an amount that,
4 you know, I don't know how the lender could spend that much
5 money short of having all of those professionals turn their
6 files to death then why are you trying to repel other bidders
7 and chill the bid.

8 THE COURT: Thank you.

9 MR. ROSENTHAL: Let me try to take a couple issues
10 off the table.

11 THE COURT: Then we'll turn to witnesses.

12 MR. ROSENTHAL: I don't think we're creating
13 administrative insolvency. The APA provides for either the
14 assumption of post-petition liabilities or the funding of
15 those liabilities with a significant wind down payment at the
16 closing somewhere in the \$8.5 million dollar range.

17 On the statutory insider questions so it's not quite
18 as simple as looking at the 13(d)'s or Silver Point's
19 ownership of the common stock is 20%. But we have two
20 classes of voting stock at both. We have a Class A stock
21 that holds five votes as compared to each vote as a common.
22 They have none of the Class A stocks. So their actual
23 percentage on an aggregate basis is 13%.

24 Ms. Levine complained about the March 23 objection
25 deadline. We were actually going to tell the Court Silver

1 Point pointed this out to us that because we have now
2 extended the bid deadline to the 11th and the auction to the
3 15th we think that June 1 for an objection deadline on the
4 sale. There's a subsequent objection deadline for June 16th
5 for whoever we end up choosing at the auction, so basically
6 two bites of the apple.

7 The June 1 date is after the expiration of the
8 Committee's period. The Court did raise a good question, I
9 think, about the procedure of what happens if the Committee
10 does file a claim complaint trying to object to the ability
11 of the lenders to credit bid or to the validity leading prior
12 to the liens. We'll have to address that down the road.
13 Right now, there is no such complaint filed. And whether the
14 Committee would have standing to bring that is, again,
15 another issue down the road. We've done our own analysis of
16 that as well of the strength of the clients.

17 Ms. Levine said that the, was talking about the
18 budget for the Committee. It is true. It is \$200,000.00 a
19 month for basically five months, so it's a million dollars.
20 She wasn't right; she was talking about other professionals
21 have higher budgets plus they have their retainers. The
22 retainers are a decrease from the budget so those budgets are
23 complete whether they're paid from new funds or retainer
24 funds.

25 Ms. Levine said we have no provision for backup

1 bidders to remain in place. It's no true. The backup
2 bidder, the number two bidder is obligated to keep its bid
3 open for 60 days so we know if the first bidder is going to
4 close. The Committee was unclear she said whether the
5 Committee can attend the auction. Of course the Committee
6 can attend the auction.

7 We can talk more if the Court wants about the
8 unencumbered, giving the unencumbered property. I think it's
9 absolutely standard for a DIP lender to get essentially all
10 the assets including unencumbered assets as collateral for
11 their loan. And we all believe that there's not sufficient
12 value to cover all of the secured debt. So to give that as a
13 replacement lien for the secured creditors is covered for
14 diminution.

15 THE COURT: I don't disagree with that as a general
16 proposition. The issue is, to be blunt, you know is this a
17 grab. And I'm not sure you can answer that from the podium
18 right now. I'll certainly hear from parties with respect to
19 that, but that's kind of the issue that a similar concept
20 arises in the context of a roll-up sometimes. You know so
21 we're rolling up and we're just, and normally roll-ups while
22 they're disliked by the Office of the United States Trustee
23 and Committees, etcetera, often a roll-up in a different case
24 is not economically neutral, but it's not as significant as
25 it might be because it's typically not grasping wide fields

1 of additional collateral. It's just prepetition debt, post-
2 petition debt.

3 We'll deal with everything post-petition. The DIP
4 order will cover everything. Again, this is not a pitch for
5 roll-ups. But you know often they're not that controversial.
6 And I've dealt with them a few times where you know the
7 problem with a roll-up is that it becomes objectionable when
8 it's really valuable. When the roll-up will extend to
9 additional collateral and give you additional rights that you
10 didn't have; not you but a lender that changes the economic
11 structure of the case on a go forward basis.

12 And so the concern I have here is that there's a DIP
13 loan that's being made. And I've seen the Committee
14 objection with respect to the we decide the terms, but first
15 whether it's necessary and, more specifically, whether it's
16 too much and too expensive. But the extension to
17 unencumbered assets is again not an unusual situation for a
18 DIP lender lending into a Chapter 11 case. But the question
19 is whether or not there is demonstrable and maybe unfair
20 improvement in a lender/bidder's position by the assertion of
21 these kind of claims for purposes of very promptly credit
22 bidding them, you know, just a couple of months later.

23 Again, I don't think I need an answer on that
24 question as long as we understand what the question is. Part
25 of it is a legal or a philosophical question of what works.

1 And then the question that I was asking Ms. Levine and I
2 would go to you guys on as well is exactly how will that
3 work. How will the assertion of that credit bid as it
4 relates to DIP collateral work so that it just means that the
5 credit bid can then extend to everything and everywhere that
6 the Debtor may have. And again what are the consequences of
7 that as an economic and practical matter.

8 So I haven't directly addressed this issue before;
9 certainly have seen plenty of credit bids that have different
10 swirly components to them.

11 MR. ROSENTHAL: I think the contemplation, Your
12 Honor, is that the DIP portion would be paid in cash. So
13 that if there's and it wouldn't be done for a credit bid. So
14 the thought is that at the time of the closing --

15 THE COURT: Just forgive them.

16 MR. ROSENTHAL: Well it's not exactly that because
17 the first lien holders are effectively the stalking horse.
18 And the vast majority of the DIP is going to be owed to the
19 ABL lenders which are entirely different parties. So they're
20 going to get paid in cash. So it's estimated that at the
21 time there will be about a \$122 million is what I've heard
22 most recently from the McKinsey folks; a \$122 million in
23 outstanding DIP.

24 Now the ABL loan facility is a \$125 million dollar
25 facility. There's a question of whether the original

1 borrowing base would allow it to go to \$125 but with this new
2 borrowing perhaps it can. So let's say it's all from the ABL
3 loan because that's within the limit of the ABL loan, so that
4 would all get repaid. And in addition to that, there would
5 be a cash infusion to the Debtor for the wind down budget
6 another \$8 or \$9 million dollars. So that's not really
7 involved in the credit bid. And the DIP loan is whatever the
8 DIP loan is. So it's entitled to be repaid. It's a post-
9 petition administrative expense anyway.

10 MS. LEVINE: Your Honor, just a [indiscernible]
11 point not responding.

12 THE COURT: Yeah sure.

13 MS. LEVINE: I just want to confirm that Your Honor
14 is not making a ruling today with regard to the insider
15 status because then that will substantially limit --

16 THE COURT: I'm not; no I'm not. I just asked the
17 question particularly for Mr. Kenney. I think the insider
18 inquiry has application well beyond the breakup fee, expense
19 reimbursement issue. And that really was what I focused on.
20 To me I think pretty consistent with Mr. Kenney's
21 observations the insider status might be dispositive if it
22 were obvious and agreed to. As a general proposition
23 insiders don't get expense reimbursements and breakup fees,
24 or at least breakup fees.

25 On the theory that they're typically not needed to

1 be incentivized, a management team would almost never get a
2 breakup fee in this Court anyway as a matter of principle.
3 So when Mr. Kenney was going through is concerns with respect
4 to it, I think that his analysis and his objection is not
5 based on the insider issue. I don't think I need to
6 necessarily reach that. I certainly don't think that I have
7 sufficient record to address that one way or the other today.

8 My point was just to ask him whether or not the U.S.
9 Trustee's objection was predicated upon an insider theory and
10 clearly it's not. His point is just as a matter again of
11 economics or business. His point is does not seem under this
12 record that Silver Point needs to be incentivized to step out
13 onto the dance floor, so I understand that. Okay. Mr. Lutz.

14 MR. LUTZ: Thank you, Your Honor, Brian Lutz from
15 Gibson Dunn on behalf of the Debtors. We're going to attempt
16 to streamline and move things along. We're going to submit
17 as evidence the declarations that had been provided already;
18 four declarations: two from Mr. Carmody and two from Mr.
19 Torgove. All of them except one are in the binders that have
20 been provided to Your Honor.

21 THE COURT: I have them.

22 MR. LUTZ: Can I submit the fourth one that happens
23 not to be in the binder?

24 THE COURT: That would be great. Thank you.

25 MR. LUTZ: The one that I just submitted to you is

1 Mr. Carmody's first day declaration which is docket number
2 two. I just have a very short direct examination of Mr.
3 Torgove just to address two very, very narrow issues that are
4 from his declarations.

5 THE COURT: Let me do two things. First, my
6 understanding is the Debtor has two witnesses today, is that
7 correct?

8 MR. LUTZ: Yes.

9 THE COURT: Is that Mr. Torgove and Mr. Carmody?

10 MR. LUTZ: Yes. And I'm sorry I should have
11 clarified. We're submitting the declarations, of course,
12 subject to cross examination.

13 THE COURT: Of course. Does the Committee have any
14 witnesses today?

15 MS. LEVINE: Your Honor, [indiscernible] on what
16 comes in on direct, we have Leon Szlezinger from Jeffries
17 with us.

18 THE COURT: Your financial advisor?

19 MS. LEVINE: Yes. And he can agree [indiscernible].

20 THE COURT: Okay. All right well we'll see how that
21 plays out. I just want to know for purposes of managing.
22 Does any other party expect to call a witness for purposes of
23 today's matters? Very well; second, I would ask are there
24 any objections to the admission of the Torgove and Carmody
25 affidavits? Both of those gentlemen are here today and will

1 be put on the stand. Okay they're both admitted.

2 [Torgove & Carmody Affidavits received into evidence]

3 And then --

4 MR. LUTZ: Mr. Torgove I was going to call.

5 THE COURT: Okay we'll call Mr. Torgove.

6 ANDREW TORGOVE, DEBTORS' WITNESS, SWORN

7 THE CLERK: Please state and spell your name for the
8 record.

9 MR. TORGOVE: Andrew Torgove; T-o-r-g-o-v as in
10 Victor - e.

11 THE COURT: Welcome. Do you have a binder up there
12 for him?

13 MR. LUTZ: I'm not sure he's going to need it.

14 THE COURT: Okay.

15 MR. LUTZ: If he does we can --

16 THE COURT: He probably will for cross.

17 MR. LUTZ: We'll get it to him.

18 DIRECT EXAMINATION

19 BY MR. LUTZ:

20 Q. Thank you, Mr. Torgove, for being here. Mr. Torgove, you
21 submitted a declaration, two declarations in support of the
22 DIP financing motion and the sales procedures motion, is that
23 right?

24 A. That's correct.

25 Q. And one of the topics that was generally addressed in

1 your declarations is The Standard Register DIP financing
2 motion, is that right?

3 A. That's correct.

4 Q. I just have two clarifying questions from your
5 declarations. First, did the Debtors seek DIP financing in
6 light of the Debtors' projected cash shortfall?

7 A. Yes.

8 Q. And, second, were the terms of the DIP financing the most
9 favorable terms that the Debtors were able to negotiate?

10 A. Yes.

11 MR. LUTZ: I have no further questions.

12 THE COURT: Ms. Levine.

13 MS. LEVINE: Your Honor, brief cross examination.

14 THE COURT: Sure.

15 CROSS EXAMINATION

16 BY MS. LEVINE:

17 Q. Good morning, Mr. Torgove; Sharon Levine, Lowenstein
18 Sandler for the Committee, how are you?

19 A. Fine.

20 Q. Mr. Torgove, prepetition where you started to look at
21 whether or not you needed DIP financing, the DIP financing
22 became [indiscernible] discussing because there was an
23 impending default under the prepetition financing facility,
24 is that correct or at least one of the factors?

25 A. It was one of the factors, yes.

1 Q. The default, however, was what we call a little
2 [indiscernible] and not a big DR payment default, correct?

3 A. It was a leverage default, leverage test default from the
4 order of 2014.

5 Q. Thank you.

6 MS. LEVINE: No further questions, Your Honor.

7 THE COURT: Any redirect?

8 MR. LUTZ: Not from me.

9 THE COURT: I wish all my hearings were like this.
10 I may regret that statement in a little while. Mr. Lutz.

11 MR. LUTZ: We have nothing further.

12 THE COURT: Well I think you need to tender Mr.
13 Carmody.

14 MR. LUTZ: Oh I'm sorry.

15 THE COURT: If the Committee wishes to examine.

16 MR. LUTZ: I'm sorry; my apologies. You intend to
17 have [indiscernible]?

18 MS. LEVINE: Yes.

19 THE COURT: Please remain standing. We'll swear the
20 witness.

21 ANDREW BELLMANN, DEBTORS' WITNESS, SWORN

22 THE CLERK: Please state and spell your full name.

23 MS. LEVINE: Actually, Your Honor, we don't need to
24 cross examine Mr. Carmody. We're just going to put on Mr.
25 MacGreevey.

1 THE COURT: Very well, you may step down. The
2 witness was so intimidating.

3 MS. LEVINE: We just have one --

4 THE COURT: Well let me just ask as a matter of
5 process because typically we would call Committee witnesses
6 after the Debtor has rested with respect to both motions.
7 And I think I'd like to make sure we're all on the same page.
8 I'm happy to be flexible about it and it may be an
9 appropriate time.

10 MS. LEVINE: I'm not sure what other witnesses.

11 MR. LUTZ: Yeah of course subject to cross
12 examination of the Committee's witnesses.

13 THE COURT: Okay, fine. You may call your witness.

14 MS. LEVINE: Your Honor, we'd like to offer --

15 MR. LUTZ: In rebuttal to the extent that
16 [indiscernible].

17 MS. LEVINE: Your Honor, we'd like to offer a
18 proffer from Mr. MacGreevey and from Mr. Szlezinger. And
19 with the Court's permission I'll turn the podium over to
20 Andrew Bellmann to read into the record.

21 THE COURT: Okay any objection to proceeding by way
22 of proffer?

23 MR. LUTZ: No.

24 THE COURT: Very well.

25 MR. BELLMANN: Good morning, Your Honor, Andrew

1 Bellmann on behalf of the Committee. As Ms. Levine noted, we
2 have two proffers. The first is of Mr. David MacGreevey of
3 Zolfo Cooper, the Committee's financial advisor. Mr.
4 MacGreevey is in the Courtroom today and available for cross
5 examination.

6 If called to the stand, Mr. MacGreevey would testify
7 that he is a managing director at Zolfo Cooper LLC, a
8 financial advisory firm with principle offices located at
9 1114 Avenue of the Americas, 41st Floor, New York, New York
10 10036 as well as at other locations. Mr. MacGreevey would
11 further testify that [indiscernible] he has been advised in
12 more than 30 Chapter 11 cases most involving --

13 THE COURT: [indiscernible].

14 MR. BELLMANN: Pardon me?

15 THE COURT: Let's do the merits.

16 MR. BELLMANN: Understood. Mr. MacGreevey would
17 testify that on March 24th, 2015 the Committee appointed in
18 these cases retained Zolfo and that he's reviewed the motion
19 for post-petition financing, the credit agreement, and the
20 declarations submitted by the Debtors in connection with the
21 motion. Based upon the review of those documents, the record
22 in these cases, and discussions with the Debtors'
23 professionals Mr. MacGreevey would testify that in his view
24 the proposed financing as currently structured is overly
25 burdensome and to an extent may not be necessary.

1 Mr. MacGreevey would testify that first the value of
2 the prepetition ABL collateral, the Debtors' cash, accounts
3 receivable, inventory, and the program property plant
4 equipment is sufficient to provide the DIP ABL lenders with
5 adequate collateral. The Debtors admit in the DIP motion
6 that the ABL DIP lenders primary collateral "heavy value
7 substantially greater than the value of their claims." In
8 fact, as of February 28th, 2015 the Debtors' balance sheet
9 reflects more than \$200 million dollars of cash, accounts
10 receivable and inventory.

11 In comparison, the maximum amount to be drawn in the
12 DIP ABL during latest projection period is a \$116.1 million
13 dollars. As such, there's no need to extend the ABL under
14 its collateral by granting liens on previously unencumbered
15 assets including avoidance actions, 35% of the Debtors'
16 equity interest in foreign subsidiaries, and the assets of
17 the Debtors who were not previously parties to the
18 prepetition ABL facility.

19 Mr. MacGreevey would further testify that the
20 Debtors request for \$30 million dollars in the form of a DIP
21 term loan appears to be excessive. During the first 17 weeks
22 of the Chapter 11 cases the budget reflects a maximum
23 principle balance under the DIP term loan of approximately
24 \$13.9 million dollars with the first draw of \$800,000.00
25 coming two months into the process. The projected need for

1 this DIP appears to be the product of a budget that was built
2 on a number of flawed assumptions that exaggerate or front
3 load the Debtors' projected cash needs.

4 For example, the original DIP budget assumes that
5 all creditors of the Debtor immediately demand
6 [indiscernible] COD payment terms. The Debtors would expend
7 \$20 million dollars on critical vendor obligations during the
8 first weeks of the bankruptcy. And the customers with
9 prepaid postage deposits would demand refunds totaling \$3
10 million dollars in the early stages of the Chapter 11 cases.

11 Based on these assumptions the Debtor assumes net
12 cash flow for the first four weeks of the case negative \$16
13 million dollars. In reality through the fourth week of the
14 case, the Debtors' net cash flow was positive \$27.8 million
15 dollars; for variance, a favorable variance of \$43.8 million
16 dollars. To put this significant variance into context is
17 equivalent to 65% of the Debtors' average total revenue for a
18 four week period.

19 The effective [indiscernible] assumptions on the DIP
20 borrowing need is also significant. While the Debtors
21 originally projected to draw approximately a \$119 million
22 dollars on the DIP through the first four weeks of the case
23 ended April 5th, the actual borrowings as of that date were
24 approximately \$72 million dollars; a favorable variance of
25 \$47 million dollars or nearly 40% in just four weeks.

1 Importantly, while the Debtors may contend these
2 variances are temporary in nature is becoming increasingly
3 unlikely that these assumptions will ever become a reality,
4 unlikely that these assumptions will ever become reality as
5 customers and vendors gain a level of comfort with the
6 Debtors' Chapter 11 prospects. For these reasons, the budget
7 appears overly conservative.

8 Mr. MacGreevey would further testify that the DIP
9 loans also impose overly restricted covenants including with
10 restrictive permitted variances under the budget. Line item
11 expenditure variances generally 5% are unnecessarily
12 stringent and create the potential for default even roll over
13 on cash flows on [indiscernible] are even favorable to
14 budget. In Mr. MacGreevey's experience permitted variances
15 and DIP budgets generally range from 10 to 15% and often are
16 measured only a total net cash variances as opposed to
17 individual line items.

18 Mr. MacGreevey would further testify that the DIP
19 term loan is expensive given the [indiscernible] for the DIP
20 term loan particularly the size of the closing fee, the
21 commitment fee and the interest rate. Zolfo's analysis of
22 the proposed DIP term loan indicates that the lenders will
23 earn approximately a 63% in term rate of return if the
24 Debtors perform as projected under the revised budget. If
25 Zolfo's analysis is correct and the DIP budget is overly

1 conservative, the [indiscernible] rate of return that the DIP
2 term loan lenders earn could, in fact, be much higher.

3 Mr. MacGreevey would further testify that as with
4 the ABL loan the value of the prepetition term loan
5 collateral is sufficient to provide the DIP term lenders with
6 adequate collateral. [indiscernible] the DIP term loan is
7 secured by all the property plant and equipment of the
8 company including nine owned facilities, as well as a second
9 lien on the more than \$200 million dollars of cash, accounts
10 receivable, and inventory.

11 In comparison, the maximum amount to be drawn on the
12 DIP term loan during the projection period is just \$13.9
13 million dollars. And the maximum amount to be drawn under
14 the DIP ABL and the DIP term loan on a combined basis is
15 \$122.8 million dollars. Further, the DIP lenders enjoy the
16 comfort of an executed asset purchase agreement whereby the
17 buyer who's also an affiliate of the DIP term loan lenders
18 has agreed to a purchase price that is far in excess of the
19 DIP lender's loan exposure by at least a \$145 million
20 dollars. As such, the extension of the term lenders
21 collateral package to include previously unencumbered
22 collateral is not warranted under the circumstances.

23 Mr. MacGreevey would further testify that in his
24 view the previously unencumbered collateral proposed to
25 secure the DIP loans and, in particular, the DIP term loan is

1 an attempt by the lenders to envelope these previously
2 unencumbered assets into their credit bid through the
3 Debtors' assets through a Section 363 process.

4 In sum, Mr. MacGreevey would testify that for these
5 and other reasons set forth in the Committee's objection to
6 the DIP motion, the DIP motion should not be approved as
7 proposed. That completes the proffer of Mr. MacGreevey who
8 is available for cross examination.

9 UNIDENTIFIED SPEAKER: Could we just take a minute
10 to confer?

11 THE COURT: Yeah why don't we do this, two things.
12 We'll just take a five minute break and if you need more time
13 then I'm happy to accommodate. I'll accept the proffer. And
14 it's obviously not just the Debtor. Any party that wishes to
15 cross may do so. Second, I kind of fast forwarded you
16 through the witnesses' background which is kind of my
17 practice but I did not necessarily anticipate whether the
18 Debtor has any issues with the witnesses' qualification or
19 background. And if you wish, you're welcome to examine on
20 that or expand the proffer to readdress that issue. Then
21 we'll move on to the meat of the matter, but I didn't want to
22 cut anybody off.

23 So why don't we do this, we'll take five minutes and
24 we'll reconvene for cross. Stand in recess.

25 [Recess 11:09:40 - 11:26:52]

1 THE CLERK: All rise.

2 THE COURT: Please be seated. Ready to proceed.

3 Welcome. Please swear the witness.

4 ANDREW MACGREEVEY, COMMITTEE'S WITNESS, SWORN

5 THE CLERK: Please state and spell your full name.

6 MR. MACGREEVEY: It's David MacGreevey; M-a-c-G-r-e-
7 e-v like victor, e-y.

8 THE COURT: Welcome. Mr. Lutz.

9 MR. LUTZ: Thanks.

10 CROSS EXAMINATION

11 BY MR. LUTZ:

12 Q. Hi, Mr. MacGreevey, how are you?

13 A. Good morning.

14 Q. Thanks for being here. I just have a couple of questions
15 based on your proffer read by your counsel. Your proffer
16 addresses, part of your proffer addresses the DIP budget that
17 supported the DIP financing in this case, is that right?

18 A. Correct.

19 Q. And your understanding is that McKinsey was responsible
20 for putting together that DIP budget, is that right?

21 A. That's my understanding.

22 Q. And your understanding of that is based on reviewing the
23 filings in this case?

24 A. Discussions with McKinsey.

25 Q. And you've reviewed Mr. Carmody's declaration submitted

1 in this case, is that right?

2 A. Correct.

3 Q. So you're familiar generally with the contents of those
4 declarations?

5 A. Yes, generally.

6 Q. Your understanding is that McKinsey spent several weeks,
7 six weeks putting together the DIP budget, is that right?

8 A. It may have been. I know they were retained in January
9 at some point.

10 Q. And you understand that McKinsey, among other things,
11 spoke with management in putting together the DIP budget, is
12 that right?

13 A. Yes.

14 Q. They spent a lot of time putting together the DIP budget?

15 A. Yes.

16 Q. Part of your proffer, I think, it went quickly, but I
17 think one of the things that was said was that you believe
18 that the DIP budget contained overly aggressive assumptions,
19 is that right?

20 A. Overly conservative.

21 Q. Overly, excuse me, overly conservative assumptions, is
22 that right?

23 A. Correct.

24 Q. And you had a chance, obviously, to dig into the DIP
25 budget, right?

1 A. We looked at the DIP budget filed at the time of the
2 bankruptcy to reforecast as of March 27th, as well as the
3 reforecast as of April 10th that came out Friday night.

4 Q. Have you been on site in Dayton?

5 A. No.

6 Q. Have you met with Joe Morgan, the company's CEO?

7 A. No.

8 Q. Have you met with Ben Cutting the company's CFO?

9 A. No.

10 Q. Have you met with Bob Ganan [*phonetic*], the company's
11 former CFO?

12 A. We have not.

13 Q. Have you met with Jim Vaughn, the company's treasurer?

14 A. No.

15 Q. Have you met with Greg Greve, the company's head of
16 operations?

17 A. No.

18 Q. Have you met with anybody at management in connection
19 with your analysis of the DIP budget?

20 A. We haven't been out to Dayton. We've had telephone calls
21 with the professionals McKinsey and Lazard. There may have
22 been members of management on those calls. I can't recall.

23 Q. Have you personally had a conversation with a member of
24 management about the contents of the DIP budget?

25 A. No, not directly.

1 Q. Have you met with customers of Standard Register
2 concerning the DIP budget?

3 A. No.

4 Q. Or the assumptions in the DIP budget?

5 A. No.

6 Q. Or the company's performance over time after the DIP
7 budget was put in place?

8 A. No.

9 Q. Part of your proffer, I believe, addresses what you call
10 variance of the company's performance relative to the budget,
11 is that right?

12 A. That's correct. Their actual performance in the first
13 four weeks relative to their projections.

14 Q. Right and you recognize in your proffer that the company
15 has performed in a positive variance relative to budget in
16 that limited period of time?

17 A. In that four week period, correct.

18 Q. Have you conducted any analysis as to how the company
19 would have performed had it not had a DIP budget in place
20 during those four weeks?

21 A. No.

22 Q. Any analysis of how customers would have reacted had a
23 DIP budget not been in place?

24 A. I'm not sure you can do an analysis on that. It sounds
25 like speculation. You can speculate how customers and

1 vendors would react in one situation versus another.

2 Q. And have you done that?

3 A. Have we speculated on that, no.

4 Q. Have you conducted any kind of analysis as to how the
5 company would have performed in this four week period if it
6 had not had a DIP budget?

7 A. No.

8 Q. Are you aware that the company has certain critical
9 vendor payments that have not been paid but the company
10 expects to pay during the bankruptcy period?

11 A. I understand the company has a \$20 million dollar maximum
12 critical vendor payment program and it projects to make those
13 payments originally projected in the first four weeks of the
14 case, now projected beginning April 19th and for the four
15 weeks thereafter.

16 Q. Do you know approximately how much of those critical
17 vendor payments to date have not been paid?

18 A. I believe the majority have not been paid yet.

19 Q. The majority of the \$20 million.

20 A. Have not been paid.

21 Q. And you understand that the company, in fact, intends to
22 make those payments during the bankruptcy period?

23 A. I understand that the company is entertaining critical
24 vendor status with their foreign vendors. I don't know how
25 much they actually intend to make of those \$20 million.

1 They've budgeted for all \$20 million.

2 Q. And your understanding is that the vast majority of that
3 \$20 million has not been paid in that four weeks that
4 commenced since the -- that lapsed since the commencement of
5 the bankruptcy?

6 A. Correct.

7 Q. I also heard your proffer you made some statements about
8 Silver Point using a lien on the unencumbered assets of the
9 DIP as part of the credit bid, did I get that right?

10 A. Correct.

11 Q. Can you explain your understanding of that portion of
12 your proffer just so we have it clear?

13 A. Yeah I think the thought process is to the extent that
14 these unencumbered assets are now part of the DIP, the
15 debtor-in-possession financing package, that they can be
16 rolled into the purchase of the company as opposed to the
17 ultimate buyer of the company paying for those assets
18 separately.

19 Q. What's the basis for your understanding that the lien on
20 the unencumbered assets is going to be rolled over and used
21 as current and can't be rolled over and used as part of the
22 credit bid?

23 A. I think it's a concern of ours.

24 Q. Which the basis of your understanding that that's the way
25 it works because I think it's not how it works.

1 A. Basic understanding is looking at the purchase agreement,
2 the sale motion.

3 Q. Have you looked at all the papers that were filed on that
4 issue in this case?

5 A. I read the sale motion.

6 Q. Your proffer addresses this issue -- your proffer
7 addresses the issue of the use of unencumbered assets as part
8 of the DIP collateral.

9 A. Yes.

10 Q. And my understanding is that -- or let me ask you this.
11 Have you worked on a case where a DIP loan is collateralized
12 by, not collateralized by unencumbered assets?

13 A. So we're currently representing the Committee
14 [indiscernible] and the avoidance actions remain unencumbered
15 there. We're wrapping up the Committee's representation for
16 Exide and the preferences and avoidance actions remain
17 unencumbered there and [indiscernible] general unsecured
18 creditors trust. We're wrapping up the Committee's
19 representation on debt stores where the preferences remain
20 available for unsecured creditors.

21 Q. Is it your understanding that it's generally the case
22 that a DIP loan will be secured by previously unencumbered
23 assets, generally?

24 A. I think in some circumstances you could have security of
25 a previously encumbered. In some circumstances it leaves

1 them unencumbered.

2 Q. Have you done any analysis of the number of cases in
3 which DIP loans were secured, were not secured by
4 unencumbered assets; assets that previously were
5 unencumbered?

6 A. Well it's a lot of DIP loans, so no we haven't looked
7 back at that. But what we've done is we've looked at a
8 recent exposure in Committee cases in this district and
9 thought about that meaning how I divided that
10 [indiscernible].

11 Q. Well anything broader than the cases that you've worked
12 on? Did you look at, canvass the market?

13 A. Yeah we did database. And we've looked at for debtor-in-
14 possession financing provider in 2014. And, again, certain
15 of those cases the unencumbered will remain unencumbered.
16 And certain of them the unencumbered or portions thereof will
17 be become [indiscernible] of the DIP.

18 Q. What basic portion, what do you mean? How many of the
19 cases that you looked at in your database involve cases where
20 the DIP loans included previously unencumbered assets as
21 collateral?

22 A. I can't recall.

23 Q. I think you also mentioned in your proffer and correct me
24 if I'm wrong because it went very quickly. But you believe
25 the rate of return on the DIP is about 64%?

1 A. In what way? I'm sorry. My understanding is that the
2 company draws it as they require it.

3 Q. Sixty-four percent internal rate of return is pretty
4 good, right?

5 A. Terrific.

6 Q. Are you aware of any other lenders who said hey, this is
7 a 64 percent internal rate of return, what a jump on us?

8 A. My understanding from attending Mr. Torgrove's deposition
9 is that they talked to six other potential lenders. I
10 assumed that they outlined to them their potential need for
11 DIP financing. I don't know if they ever entertained term
12 sheets from those lenders or expressly stated this is going
13 to be a 64 percent return case. So I don't know.

14 Q. What you do know is that no other lenders, other than the
15 existing secured lenders, were willing to provide DIP
16 financing?

17 A. Yeah, my understanding is under the circumstances where
18 there would have been a priming issue that the other six
19 lenders were not interested in participating.

20 MR. LUTZ: Okay. No further questions.

21 THE COURT: Further cross.

22 MR. MEISLER: Your Honor, Ron Meisler of Skadden
23 Arps on behalf of Silver Point Finance, LLC.

24 THE COURT: Welcome.

25 CROSS-EXAMINATION

1 BY MR. MEISLER:

2 Q. Mr. McGreevy, I want to go back on the question with
3 respect to DIP's and encumbering previously unencumbered
4 assets.

5 A. Okay.

6 Q. Mr. McGreevy, have you been involved in DIP financing in
7 many different cases?

8 A. Yes.

9 Q. In your experience, have you seen a DIP loan that is
10 limited solely to prepetition previously encumbered assets?

11 A. I can't recall.

12 Q. Do you think --

13 A. There is certainly significant experiences or a number of
14 experiences where they leave the avoidance actions as
15 unencumbered.

16 Q. Are the avoidance actions all the unencumbered assets or
17 do you think that avoidance actions are --

18 A. So, and I didn't mean to cut you off there, but the DIP
19 lender also left 35 percent of the equity in the foreign subs
20 as unencumbered.

21 Q. Do you think it's typical for 35 percent of equity in
22 foreign subsidiaries to be unencumbered in a prepetition
23 loan?

24 A. It's something that we have seen before. I can't
25 handicap whether we have seen it more often than not.

1 THE COURT: I'd like some clarity. Mr. Meisler, you
2 are welcome to provide it if you want. I'm not trying to
3 intrude or step on the examination of the witness, but there
4 are a couple different things that I am trying to get my head
5 around. The first is, I think your last question was is it
6 unusual for 35 percent of the equity in a foreign subsidiary
7 to be left out of a prepetition loan. I think that's
8 something I have certainly seen before. It's often driven by
9 regulations in foreign countries about ownership, etc. Leave
10 that aside.

11 The inquiry about situations where a Debtor comes in
12 and, I guess I am trying to draw a distinction between a
13 situation that we commonly see where you got a lead lender or
14 lead lender group that has a first lien on everything and
15 they are making the DIP loan. That is somebody with a lien
16 on everything who is, effectively, priming themselves with a
17 DIP. It's not unusual, but in that situation, typically,
18 other than avoidance actions, there are no unencumbered
19 assets. So the argument comes down to a question about
20 avoidance actions, do I have that right?

21 MR. MEISLER: That's correct.

22 THE COURT: Okay. So in this situation we have a
23 Debtor that has assets other than avoidance actions. I
24 understand avoidance actions and we have this discussion all
25 the time, but these are unencumbered assets of value that I

1 am not in a position to determine. The DIP lender is making
2 a loan saying I want a first lien on unencumbered assets, the
3 equity of the subsidiaries plus, obviously, the avoidance
4 actions. I think that's what we are looking at here, right?

5 MR. MEISLER: That's right, Your Honor.

6 THE COURT: Okay. Then, the witness's testimony is
7 a concern that these are liens, leave avoidance actions out
8 of it for a minute, but the liens that will attach to the
9 unencumbered prepetition assets are advantaging Silver Point
10 or the bidder/lender for insufficient value or that there is
11 not much of a return. I guess there are two different
12 theories. It's not necessary and that it's too much value.

13 MR. MEISLER: I think that is correct.

14 THE COURT: I think I understand the testimony. I'm
15 just trying to keep up with you guys.

16 MR. MEISLER: Understood, Your Honor. If I could
17 unpack it because I actually think it's not that difficult
18 and also to put in nuance, it's not always the case that a
19 lender has blanket liens on all assets.

20 THE COURT: Sure.

21 MR. MEISLER: In fact, in complicated financing
22 transactions there are many instances where there are certain
23 pools of collateral that are outside the security package,
24 outside of the collateral package. This is an instance
25 that's consistent with that approach. In this instance,

1 there is a handful of assets that are outside of the
2 collateral pool. As can be noted in our adequate protection
3 package, the second lien lenders don't get cash interest on
4 their second liens and there is a reason for that. The
5 reason is that we are uncertain that the collateral pool for
6 the prepetition lenders is sufficient to satisfy the
7 principal amount and accrued interest on their loan.

8 So, Your Honor, as we were asked to provide DIP
9 financing, which is new money financing, and as we were doing
10 the credit underwriting to make that loan, and Your Honor to
11 be clear, we are making that loan because when Bank of
12 America and Wells Fargo were asked to make that loan and they
13 were making it pursuant to an asset based loan --

14 MS. LEVINE: Your Honor.

15 THE COURT: He's testifying, but I asked.

16 MS. LEVINE: Okay.

17 MR. MEISLER: They weren't able to extend the amount
18 of debt that the Debtors were seeking. So we were approached
19 to ask if we could fill the gap between where the formula,
20 under the ABL reached, which at its max was approximately
21 \$116 million dollars, to where the Debtors needed as far as
22 they were projecting for cash needs. We were there for the
23 Debtors with respect to that amount.

24 When we did the credit underwriting, we believed
25 that there was significant uncertainty as to the value of the

1 prepetition collateral pool being able to satisfy our
2 prepetition loans; therefore, when we agreed to extend new
3 money loans, we needed that extra collateral pool to support
4 the credit extension.

5 THE COURT: I understand the issue. So you are
6 welcome to examine the witness further if you had any other
7 questions, but I think you responded to my --

8 MR. MEISLER: Your Honor, I don't have any further
9 questions.

10 MS. LEVINE: Your Honor, brief re-direct.

11 THE COURT: Sure.

12 RE-DIRECT EXAMINATION

13 BY MS. LEVINE:

14 Q. Good morning, Mr. McGreevey.

15 A. Good morning.

16 Q. You just heard counsel talk about the adequately
17 protecting new money loans, did you hear that testimony or
18 that oral argument?

19 A. I did.

20 Q. Currently, with regard to the term loan, how much has
21 been drawn on the term loan?

22 A. The DIP term loan?

23 Q. Yes, the Silver Point term loan.

24 A. \$1.05 million.

25 Q. And what was that money used for?

1 A. To pay the closing fee.

2 Q. And under the term loan, is there also an unused line
3 facility fee?

4 A. I believe its 1 percent.

5 Q. In addition to that, is there a collateral monitoring
6 fee?

7 A. I believe its \$10,000.00 a month.

8 Q. What is the source of the funds to pay for all of those
9 fees?

10 A. Extensively, it would be from the DIP term loan.

11 MS. LEVINE: Thank you.

12 THE COURT: Okay.

13 RE-CROSS EXAMINATION

14 BY UNIDENTIFIED SPEAKER:

15 Q. Mr. McGreevy, you mentioned that there is a closing fee
16 on the DIP?

17 A. It is.

18 Q. Mr. McGreevy, is it unusual for a DIP lender to have a
19 closing fee?

20 A. It is not.

21 Q. Mr. McGreevy, is it unusual to have a collateral
22 monitoring fee in a DIP?

23 A. It's not.

24 Q. Mr. McGreevy, is it unusual to have an unused line fee in
25 a DIP?

1 A. No, it's not.

2 UNIDENTIFIED SPEAKER: Thank you, no further
3 questions.

4 RE-DIRECT EXAMINATION

5 BY MS. LEVINE:

6 Q. Other than these fees, has any money been drawn on this
7 term loan?

8 A. No.

9 Q. So we are paying for the full amount of the term loan?
10 We are paying a fee on the full amount of the term loan?

11 A. You pay a closing fee of \$1.05 million.

12 Q. Sorry, the unused line fee, we are paying the unused line
13 fee on the full amount of the term loan?

14 A. On the \$29 million approximately.

15 Q. Under the budget, as it currently reads, when does the
16 Debtor anticipate it's going to draw on the term loan?

17 A. I believe there is another \$800,000.00 or so drawn, I
18 believe the week of May 17th.

19 Q. When was it originally budgeted that they would draw on
20 the term loan?

21 A. I thought it was the fourth or fifth week of the case.

22 Q. And how much was supposed to be drawn then?

23 A. Something like \$3 or \$4 million. I just can't recall off
24 hand.

25 MS. LEVINE: Thank you.

1 THE COURT: Anything further? Very well. You may
2 step down. Thank you, Mr. McGreevy.

3 MR. MCGREEVY: Thank you.

4 THE COURT: Ms. Levine, did the Committee intend to
5 call another witness?

6 MS. LEVINE: Yes, Your Honor, from Jefferies Leon
7 Szlezinger and if Mr. Bellman could read the proffer.

8 THE COURT: Do you have a copy that you can give to
9 these guys? I'm not asking for any breach of
10 attorney/client, but if you are going to read it into the
11 record, he's trying to do this on the fly. You may proceed.

12 MR. BELLMAN: Thank you, Your Honor. Pursuant to
13 Your Honor's preference, we will bypass the introductory
14 background stuff, subject to, you know, reserving the right
15 to supplement. Your Honor, this is the proffer of Leon
16 Szlezinger who is a managing director and joint global head
17 of restructuring and recapitalization at Jefferies, LLC.
18 Jefferies has been retained or proposed to be retained as the
19 Committee's investment banker in this case.

20 Mr. Szlezinger would testify that he and Jefferies
21 professionals have extensive experience in knowledge,
22 analyzing, restricting, negotiating and effecting mergers,
23 acquisitions and divestitures, and providing other financial
24 support related to asset sales both in and out of Chapter 11.
25 Mr. Szlezinger would further testify that in his six year

1 tenure at Jefferies he has been involved in at least 13 M&A
2 transactions, both in and outside of Chapter 11. Prior to
3 his tenure at Jefferies, Mr. Jefferies was involved in
4 numerous M&A transactions.

5 Mr. Szlezinger would further testify that on March
6 24th, 2015 the Official Committee of Unsecured Creditors
7 appointed in these cases, subject to Court approval, retained
8 Jefferies as its investment banker. Mr. Szlezinger leads
9 that engagement. Since its retention, Mr. Szlezinger would
10 testify that Jefferies has reviewed the Debtors' sale motion,
11 the stalking horse APA and the declaration submitted by the
12 Debtors in connection with their sale motion.

13 Based upon his review of the record and documents
14 filed in these cases, as well as discussions with the Debtors
15 retained professionals and prospective purchasers, Mr.
16 Szlezinger would testify that in his view the proposed sale
17 process is not structured in such a way as to maximize the
18 value of the Debtors' businesses. In particular, Mr.
19 Szlezinger would testify that certain changes to the proposed
20 sale procedures would increase the likelihood of a spirited
21 auction process. For example, Mr. Szlezinger would testify
22 that potential bidders may disinclined to submit a competing
23 bid or be involved in the process if the secured lenders were
24 permitted to credit bid the large outstanding amounts under
25 their prepetition facilities, together with potentially

1 amounts provided as bid protections. Placing [indiscernible]
2 rights is likely to encourage auction participation and
3 competitive bidding.

4 Mr. Szlezinger would further testify that the
5 estates would likely benefit from a reasonable extension of
6 the sale deadlines of 60 days given the Debtors' very limited
7 prepetition marketing, the limited progress made with the
8 potential acquirer universe on a post-petition basis and the
9 continued lack of forward looking projections or business
10 plan, which are important elements that bidders ordinary
11 consider in the evaluation process.

12 Mr. Szlezinger would further testify that potential
13 bidders may want to purchase certain components of the
14 Debtors' business, not necessarily the entire business; thus,
15 there is no additional time to conduct due diligence and to
16 [indiscernible] and strategies for any separate businesses.
17 Mr. Szlezinger would testify that the required deposit
18 amount, 10 percent of the purchase price or approximately \$28
19 million dollars, is high right over to the stalking horse
20 deposit of just \$2 million dollars.

21 In addition, the Debtors may hold onto the deposit
22 for 60 days after entry of a sale order. These factors may
23 show bidding. Mr. Szlezinger would further testify that the
24 bid protections, both the break-up fee and the expense
25 reimbursement, which could total approximately \$9 million

1 dollars are unnecessary in light of Silver Point's
2 prepetition involvement with Standard Register and pre-
3 existing knowledge of the Debtors' businesses. Further, Mr.
4 Szlezinger would state that there is strong, that the
5 stalking horse bidder would have been willing to bid for the
6 Debtors' assets without these protections. In addition, bid
7 protections are particularly inappropriate given the
8 existence of serious interest from other potential buyers of
9 the Debtors' assets who expressed an interest in being the
10 stalking horse bidder.

11 The bid protections are more likely to chill bidding
12 rather than encourage it and often are not provided in cases
13 in which a stalking horse bidder credit bids its prepetition
14 secured claims. Mr. Szlezinger would testify that for these
15 reasons the bid procedures should not be approved as
16 proposed. That concludes the proffer of Mr. Szlezinger, who
17 is available for cross.

18 THE COURT: Do you need a minute. Sure. We will
19 break for five minutes. Stand in recess.

20 [Recess 11:54:25 to 12:02:29]

21 THE COURT: Please be seated.

22 MS. LEVINE: Your Honor, Mr. Szlezinger.

23 THE COURT: Very good. Swear the witness. Please,
24 remain standing.

25 LEON SZLEZINGER, SWORN

1 THE CLERK: Please state your full name for the
2 record.

3 MR. SZLEZINGER: Leon Szlezinger, S-z-l-e-z-i-n-g-e-
4 r.

5 THE COURT: Welcome, sir.

6 CROSS-EXAMINATION

7 BY MR. LUTZ:

8 Q. Mr. Szlezinger, thank you for being here. I just wanted
9 to touch on a couple of points from your proffer, starting
10 with the bid protections. Did Standard Register, to your
11 knowledge, have any alternative stalking horse bidders who
12 were willing to provide terms without a breakup fee and
13 expense reimbursement?

14 A. No.

15 Q. You're familiar with the declaration submitted by Mr.
16 Torgove in this case?

17 A. Yes.

18 Q. Did you review Mr. Torgove's deposition in this case?

19 A. I did.

20 Q. You understand from his testimony, don't you, that
21 Standard Register pushed back as fast as it could on the
22 request for the inclusion of an expense reimbursement and
23 breakup fee?

24 A. I believe it says that, correct.

25 Q. You understand from Mr. Torgove, his testimony in his

1 declaration that he was told by the stalking horse bidders
2 that a bid wouldn't be accepted without those provisions, is
3 that your understanding?

4 A. That he was told?

5 Q. Yeah.

6 A. I think he might have testified to that.

7 Q. Your testimony or your proffer about the 10 percent that
8 was a required deposit for bidders, correct?

9 A. Yes.

10 Q. It's your understanding, isn't it, that a 10 percent
11 deposit is standard in 363 sales processes?

12 A. Ten percent is relatively standard, but I don't think
13 that's the point that I was making in my proffer. The
14 proffer, I think as it was read, says 10 percent is high in
15 comparison to the deposit by the stalking horse.

16 Q. I understand what your proffer says. I understand from
17 your testimony right now that it is your testimony that 10
18 percent is generally standard in 363 sales processes?

19 A. I think it's relatively standard.

20 Q. I want to go to the 60 days. You say in your proffer
21 that an additional 60 days would be helpful for the sales
22 process, is that right?

23 A. I think that's what I said, yes.

24 Q. So what you are suggesting here is rather than
25 approximately a 90 day sales process, you think it should be

1 approximately a 150 day sale process, is that right?

2 A. I think that within the outside date of September 8th, the
3 deadline should be pushed back within that time scale, yes.

4 Q. Are you aware of something from a bidder that would
5 happen after 90 days that couldn't happen within a 90 day
6 sale process?

7 A. Well, I think the point I'm making is that you would
8 foster more auction activity if you had a longer time line
9 because it would enable what is generally to be able to do
10 more diligence, have financing discussions and management to
11 give fulsome presentations as bidders, hopefully, become
12 interested.

13 Q. Have you spoken to bidders who say that they are unable
14 or unwilling to provide a bid in the 90 day period, but that
15 they would provide a bid and they would be willing to do so
16 if it were extended another 60 days?

17 A. I was talking to a bidder who said that they would prefer
18 to see a longer time line.

19 Q. Did they tell you that they wouldn't provide a bid in the
20 90 day period?

21 A. They did not.

22 Q. Did they tell you that they were unable to provide a bid
23 in the 90 day period?

24 A. No, they said they would prefer a longer time line.

25 Q. Did they say that they were going to, you know, up root

1 and abandon the process if it were limited to a 90 day
2 period?

3 A. They didn't, they said more time would be better.

4 Q. You also said that one of the reasons why you think 60
5 days would be preferable is the "limited progress made with
6 the potential acquirer universe on a post-petition basis."

7 A. I think I, prepetition and post-petition, yes.

8 Q. I'm just reading the proffer. It says on a post-petition
9 basis.

10 A. Yeah.

11 Q. What is the basis of your knowledge of the post-petition
12 sales process?

13 A. Regular update conversations that I have had with Lazard
14 and documents being posted to the data room, which show
15 progress through contacting bidders.

16 Q. Your aware from your investigation or your research that
17 the company has entered into 15 NDA's with potential
18 acquirers, is that right?

19 A. I think that's right, yes.

20 Q. And the company has reached out to over 100 potential
21 acquirers to inform them of the process and to start the
22 process of engaging their interests, do you understand that?

23 A. I think that's 115, I'm not sure that they have reached
24 out to all 115.

25 Q. Over 100, let's just say.

1 A. I'm not sure that's necessarily right because in
2 conversation on Thursday of last week I was told by Mr.
3 Torgove that the company was, that Lazard was just making a
4 start on the 40 names that Jefferies had given to Lazard,
5 which would mean that they have reached out to some like 70
6 or 80.

7 Q. Okay. Are you aware that of the 15 companies who had
8 entered into NDA's, that they had commenced their diligence
9 process?

10 A. It depends what you mean by commence their diligence
11 process, but I believe that they had at least all been send a
12 confidential information memorandum.

13 Q. Is it your understanding that they have also been given
14 access to the data room that's been set up?

15 A. I think that's right, yes.

16 Q. Many of them have had meetings with management, do you
17 understand that?

18 A. Some have had meetings with management.

19 Q. And you also understand, don't you, that some of the
20 companies who have entered into NDA's are companies who had
21 expressed interest and pursued a potential transaction
22 prepetition, is that right?

23 A. A few of them, yes.

24 Q. Including one who almost got to the finish line
25 prepetition, right?

1 A. I don't want to characterize it that they almost got
2 there or not; they didn't get there.

3 Q. Let me clarify and thank you. Including one of the
4 companies who is continuing to investigate a potential
5 transaction post-petition is a company with whom the Debtor
6 engaged in substantial negotiations about a potential
7 stalking horse bid prepetition, is that your understanding?

8 A. That is my understanding.

9 MR. LUTZ: I have no further questions.

10 THE COURT: Any re-direct or cross? Very good.

11 MR. MEISLER: Thank you, Your Honor, Ron Meisler on
12 behalf of Silver Point Finance, LLC.

13 CROSS-EXAMINATION

14 BY MR. MEISLER:

15 Q. Good afternoon, Mr. Szlezinger.

16 A. Mr. Meisler.

17 Q. Nice to see you.

18 A. You to.

19 Q. Mr. Szlezinger, with respect to the credit bid and the
20 bid protections, you're not saying it's never possible in the
21 context of the credit bid to have bid protections, are you?

22 A. I mean it's always possible to have something. I am
23 saying that in this context, I don't feel it's appropriate.

24 Q. Thank you, but it's true that it is possible, that is
25 your testimony, and it's possible that there could be a

1 circumstance where you could have bid protections with
2 respect to a credit bid?

3 A. I mean, I suppose it's possible. I think the real
4 analysis goes to how invested the credit bidder has been in
5 the company, how involved it's been in the company and an
6 analysis of whether or not absent those bid protections, it
7 would be putting forward its stalking horse bid.

8 Q. Thank you. Mr. Szlezinger, do you think Standard
9 Register would be better served without Silver Point's
10 stalking horse bid?

11 A. No, I don't.

12 Q. Thank you, Mr. Szlezinger. My last question --

13 A. Unless, sorry, I was just going to say unless there was,
14 you know, an alternative stalking horse bidder, but in the
15 circumstances we are in now, no, I don't.

16 Q. Thank you. Mr. Szlezinger, have you reviewed the DIP
17 credit agreements, the DIP ABL in particular?

18 A. I wouldn't say I have done an extensive review of them at
19 all, no because the Committee has people looking at those
20 issues.

21 Q. So Mr. Szlezinger, when you say that September 8th is
22 really the outside date, from where do you get that date that
23 you think the sale procedures should go until September 8th or
24 that you should match the sale procedure to a September 8th
25 date?

1 A. I think that's a deadline that came from the DIP.

2 Q. Thank you. Are you aware that in the DIP ABL credit
3 agreement, there is a covenant that on or prior to June 19th,
4 2015 an order must be entered approving the Debtors' sale of
5 substantially all their assets?

6 MS. LEVINE: Your Honor, this is outside the scope
7 of the direct.

8 THE COURT: I'll allow it.

9 THE WITNESS: I'm sorry, could you repeat the
10 question?

11 BY MR. MEISLER:

12 Q. Are you aware that there is a covenant in the DIP credit
13 agreement and the ABL in particular that on or prior to June
14 19th, 2015 there must be an order approving the Debtors'
15 motion to sell substantially all of their assets?

16 A. Yes, I believe.

17 Q. Are you also aware, Mr. Szlezinger, that the DIP credit
18 agreement has a covenant that says, sorry, this is in the ABL
19 in particular, that says 30 days, the covenant says 30 days
20 after entry of the sale order, if the sale and Debtors'
21 assets pursuant to such an order has not been closed for any
22 reason other than the issuance or the stay pending appeal
23 from the sale order, are you aware of that covenant?

24 A. Could you just read it again?

25 Q. That if the buyer and the seller don't close on the

1 transaction 30 days after the sale order has been entered
2 approving the sale, are you aware that that covenant exists?

3 A. I think I am generally aware.

4 Q. And if you take June 19th and you add 30 days, Mr.
5 Szlezinger, approximately what date do you get?

6 A. July 19th.

7 Q. Terrific and, Mr. Szlezinger, in that context if we took
8 your approach and the sale procedures last until September
9 8th, do you believe that we would have a default under the DIP
10 ABL?

11 A. Again, I haven't analyzed those defaults. I think, you
12 know, my testimony has been that you would get more auction
13 activity if you had a longer time line in which they are
14 running the sales process.

15 Q. Terrific, but, Mr. Szlezinger, do you believe that the
16 sale process would be harmed in the face of a DIP default?

17 A. I think generally a DIP default would not be a good
18 thing.

19 Q. Mr. Szlezinger, if I told you that if you went all the
20 way to September you, in fact, would have a DIP default.
21 Would you agree that going to September 8th is, in fact, a bad
22 idea?

23 A. Again, I think that a DIP default wouldn't be a good
24 thing in the context of a sale. I agree with that.

25 MR. MEISLER: Thank you. That's it, Your Honor.

1 THE COURT: Re-direct?

2 RE-DIRECT EXAMINATION

3 BY MS. LEVINE:

4 Q. Mr. Szlezinger, just a couple of questions on re-direct.

5 In the cross-examination by Debtors' counsel, they kept

6 talking about a 90 day time period. I am assuming that that

7 90 day time period ran from the filing of the petition

8 through the current sale time line. Isn't it true that the

9 sim was first posted to the data room on April 2nd?

10 A. Yes, I think that is correct and the sim did not contain

11 projections, which buyers would undoubtedly want to see. So

12 I would say a possible sim almost.

13 Q. And has a business plan been posted to the data room as

14 we sit here today to your knowledge?

15 A. It hasn't. My understanding is that it's not complete.

16 So buyers that want to look at the future for the business

17 are unable to do so.

18 Q. Did you request any meetings with management as part of

19 your diligence?

20 A. Yes, we did a couple of days after we were hired by the

21 Creditors Committee, we requested management presentations

22 and we have not been afforded that opportunity.

23 Q. In your review of the asset purchase agreement that's

24 currently the credit bid asset purchase agreement or the

25 stalking horse bid, is there any distribution contemplated to

1 unsecured creditors?

2 A. There is not.

3 MS. LEVINE: Thank you.

4 MR. LUTZ: Just one quick question.

5 RE-CROSS EXAMINATION

6 BY MR. LUTZ:

7 Q. Is it your understanding that the business plan is going
8 to be available on April 15th?

9 A. I think it was not specifically said April 15th. At some
10 point this week I was told that there would be some sort of
11 business plan.

12 Q. April 15th is this week.

13 A. Well, April 15th is Wednesday, but I wasn't told it would
14 be on Wednesday.

15 Q. Is it your understanding that on April 2nd, the date that
16 you testified about, there were approximately 1,100 other
17 documents available to folks who had access to the data room?

18 A. I'm not sure if 1,100 is --

19 Q. Is it your understanding there are a lot of documents
20 that were available to bidders or potential bidders who had
21 access to the data room?

22 A. There is a lot of documents in the data room.

23 Q. And that was also true on April 2nd, right?

24 A. Yeah, none of them are financial projections.

25 MR. LUTZ: Thank you. No further questions.

1 THE COURT: Thank you, sir, you may step down. Why
2 don't we do this; this is a good time to break for lunch. We
3 will reconvene at 1:30 and I would like to, at least, given
4 that I haven't had argument and I am not sure whether the
5 evidence is closed, but I at least have some observations
6 that I would share with you and perhaps you might discuss
7 during the lunch break and maybe parse some of these issues
8 down.

9 I want to be clear that many, many issues have been
10 raised in the various objections of the U.S. Trustee,
11 particularly the Committee and we haven't touched on the PBGC
12 as well. I think it would be appropriate for me, at least at
13 this point, to share what my observations are, subject,
14 obviously, to being convinced otherwise.

15 First, with respect to the issue of time line, I am
16 not particularly troubled by the time line that the Debtors
17 have proposed that puts us into June. The fact of the matter
18 is that more time, I think, is generally better if you are
19 looking to get a buyer, but the fact of the matter is that
20 also that we have to evaluate this within the context of a
21 bankruptcy proceeding. There is a substantial amount of time
22 that has begun. I give relatively limited significance to
23 the prepetition marketing effort. I take it at face value,
24 but, frankly, every case presents a prepetition marketing
25 effort of one form or another. It hadn't occurred under my

1 review, so I am not really going to attribute that much
2 significance to it. That becomes a much more significant
3 issue when a Debtor is looking to move on more of a
4 lightening pace.

5 This is, obviously, a large business being sold in a
6 hurry, but this is something that we have seen before. So at
7 least my instincts are that while I understand the
8 Committees' request that the process be extended out, I am
9 not satisfied on the record before me today that that is
10 necessary or appropriate. I take it, again, the Debtors'
11 concerns with respect to the risk to the process. I will
12 note that I don't attribute that much significance to the
13 prospect of a DIP default associated with that. Milestones
14 and tying the bid procedures together with the DIP order,
15 that is, I guess the state of the art, but it is not the
16 prospect of a DIP default that is leaving me to side with the
17 Debtor on the issue of timing. I am satisfied, at least on
18 the record before, that timing is sufficient.

19 At a later point, and I have done this on a number
20 of occasions, if the record develops that there is interest
21 or that the time line is not sufficient, then I would hear
22 from the Committee or any other party in interest that would
23 seek to push that process out, but at least at this point, it
24 would seem to me that the time line is not inappropriate. I
25 would also observe that, at least on the record developed

1 before me, it is highly unlikely that I would approve a
2 breakup fee for Silver Point in this situation.

3 For reasons largely stated by the United States
4 Trustee, that I won't necessarily repeat, breakup fees are
5 cautiously given. We approve them with some regularity, but
6 I think the case law in this jurisdiction and in the Third
7 Circuit require that I make a specific finding that that
8 breakup fee is necessary to preserve property of the estate
9 and I am not, at least, satisfied on the record that I have
10 before me that this is, in fact, necessary.

11 The record does reflect that Silver Point is
12 substantially invested on an equity and a secured creditor
13 basis. While I think the witness testified without, frankly,
14 much contradiction that the stalking horse opportunity
15 provided by Silver Point in this case is helpful to the
16 Debtor and I think Mr. Szlezinger testified that this would
17 be worse if we didn't have a stalking horse. The fact of the
18 matter is that under these circumstances, I would not be
19 prepared to approve a breakup fee on the record thus
20 developed before me.

21 With respect to the expense reimbursement, the
22 expense reimbursement is in excess of what I would be
23 prepared to approve. The reason is that it's a lot of money.
24 I recognize that there are costs associated with doing these
25 transactions, but the record also reflects that substantial

1 expenses were reimbursed or paid in connection with the DIP
2 financing and as this hearing has reflected, the DIP
3 financing and the sale transaction in many ways conquer the
4 same ground.

5 So it seems to me that a breakup fee north of \$2
6 million, as currently described, you know, \$1.5 or actually
7 approaching \$4 million dollars, a \$1.5 percent amount is
8 beyond what is necessary, beyond what is appropriate. I
9 realize it's subject to documentation, but that's a larger
10 number then I would be prepared to approve. The fact that
11 it's subject to documentation does not mean that it won't
12 necessarily have a chilling effect on bidding. If it comes
13 in lower, the fact of the matter is any competing bidder has
14 to assume it's the full nut.

15 With respect to credit bidding, again, there is
16 nothing, at least in the record before me, that would require
17 me to preclude or impair Silver Point's request to credit
18 bid, but I note that the Committee is doing its investigation
19 and that process will play out. Clearly, we will be past the
20 expiry of the challenge period, presumably by the time that
21 we get to the auction and sale process unless that period is
22 extended. I will not entertain extending it today, nor will
23 I entertain a request for standing today, but we have dealt
24 with this issue before. We dealt with it by agreements
25 between the parties and a number of different structures that

1 I don't think I need to explain to you.

2 The fact of the matter is that the response or the
3 issue that I would be focused on in this context about the
4 Committee investigation and where we go from here is that I
5 am unlikely to be enthusiastic about being placed in a
6 position of considering emergency motion practice on the eve
7 of a Committee deadline. How we deal with that is really up
8 to you, but I am not going to grant standing today and I am
9 not going to extend that period today.

10 Second, with respect to the credit bidding, I leave
11 to the financial advisors and folks that will be running this
12 auction, at least the observation that it may be that there
13 are issues with respect to the validity, extent and priority
14 of Silver Point liens when you get to an auction. I
15 understand that that is, at least, currently a default
16 element under the DIP as well as withdrawal right of the
17 stalking horse. I think I need to understand that a little
18 bit more. So I am not really able to give you comment on
19 that at this point.

20 The fact of the matter is that a Committee is doing
21 its investigation and our local rules, I think good policy
22 require that they be afforded the opportunity to do that.
23 With respect to the liens on previously unencumbered assets,
24 we have talked a good deal about that and I would certainly
25 welcome further guidance from the parties, but to be clear on

1 at least one point, in the face of a Committee objection, I
2 am very unlikely to approve a lien on avoidance actions. I
3 don't know that I have done so over a Committee objection in
4 the past, but in the context of this case, I would be
5 unlikely to do so today.

6 There is an interplay between that lien on avoidance
7 actions in the sale process, which is whether or not the
8 buyer of a company wants their customers and vendors to be
9 subject to the possibility of Chapter 5 litigation. That is
10 a separate issue to me, to the inquiry about whether or not
11 the lender is entitled or can be granted liens on avoidance
12 actions. So, again, my practice in that area is that I would
13 be unlikely to approve or authorize that with respect to at
14 least that category of unencumbered assets.

15 With respect to, I guess, two separate areas, the
16 cap on the investigating liens, which is \$25,000.00, which I
17 regard as a plug number, certainly not realistic in the
18 context of this case and the UCC professional budget. It is
19 generally my practice not to dictate what numbers I would
20 like or what I think is out there. In the absence of
21 consensus with respect to those elements, especially, and at
22 least some issue with respect to wind down, I am unlikely to
23 approve a 506(c) waiver, particularly over a Committee
24 objection.

25 I do believe that the UCC budget is light. I know

1 nobody likes giving the UCC funding, but that is you call
2 your congressman, they are a part of the process. But,
3 again, my practice is that I do not plug in those numbers
4 because I just don't believe that I have any basis to do so.
5 I would also observe that in other situations and in this
6 situation today, if need be, I will reserve to myself the
7 right to allocate amounts that are provided for under the DIP
8 financing budget in order to ensure that the Committee is
9 fairly compensated. That may be a fee application issue.

10 With respect to a couple little specific issues,
11 it's my expectation that the standard arrangements for
12 attendance at an auction and consultation opportunities and
13 privileges for a Committee will be accorded here. I expect
14 that the parties will be able to work out objection deadlines
15 in the filing and briefing submissions. Most of this is
16 ground that parties have plowed before. I do think that a
17 deposit of 10 percent, while it's a typical number, not
18 unusual, I think that it is high in this context given the
19 amount of the overall transaction. So I do have some
20 concerns that having to post a deposit of up to \$30 million
21 dollars and leave it sitting can have a negative effect on
22 somebody's willingness to even go down that path, but I leave
23 that, again, to the financial advisors and others. To me,
24 again, on my instincts, that does seem a bit of concern.

25 There was colloquia with respect to budget variance

1 items and a 5 percent versus 10 percent, again, in my
2 experience 10 percent is a relatively common figure, 5
3 percent if there is a reason for it. I think someone needs
4 to explain it to me, but the concern I have is, at least
5 initially as articulated by the Committee, that this may
6 trigger a default. Again, where a lender is lending into a
7 post-petition situation that can identify the defaults, the
8 exercise of their remedies is subject to, obviously, motion
9 practice and authority by this Court. I think I need some
10 guidance on exactly what that issue is. That may be a
11 smaller issue.

12 I also realize that in my comments I haven't covered
13 everything that everybody has laid out, but, again, it's been
14 difficult to follow with the way that the, and I mean no
15 criticism, but the way that the evidence has kind of come in.
16 We haven't necessarily walked through all of these items, but
17 Mr. Rosenthal, at the beginning of the hearing, I think you
18 had tried to point out a number of issues that were taken off
19 the table. My goal with my now extended comments today
20 would, at least, be to give the parties something they can
21 confer upon and those issues that remain in material dispute,
22 I would be happy to address, but, hopefully, again, this is
23 nobody's first rodeo in this room.

24 We have seen sales. This is a sale case. I accept
25 that. It will proceed on a schedule and it will proceed in

1 an effort to maximize value for all parties in interest.
2 With those observations I would leave you to lunch and I will
3 see you at 1:30. We stand in recess.

4 [Recess 12:35:11 to 1:54:40]

5 THE COURT: Please be seated. Mr. Rosenthal.

6 MR. ROSENTHAL: Your Honor, we did have an
7 opportunity visit, right before Court began, with Silver
8 Point. I think they are prepared to make a proposal. I can
9 tell it to you, but I think it's better coming from them.

10 THE COURT: Okay.

11 MR. ROSENTHAL: Do you want me to hand it up?

12 UNIDENTIFIED SPEAKER: I think we probably first
13 want to hear all the issues before, unless that's all the
14 issues that are on the table, in this case, yes.

15 THE COURT: Well, have you conferred with the
16 Committee?

17 UNIDENTIFIED SPEAKER: We have not.

18 THE COURT: Here is the thing; that's fine and I
19 appreciate the effort into formulating a proposal. There are
20 obviously a number of moving parts. I shared with you the
21 observations I had as to a number of them. There was
22 obviously, I'm not sure who put the pavlovian reflex line
23 into their brief, but there were a lot of issues that were
24 raised by the Committee, that none of which were terribly
25 surprising. Whether we respond to each of those is anybody's

1 guess at this point.

2 My goal was to sort of formulae the dynamic and to
3 make it clear to all parties that we were moving forward from
4 today, that there will be a sale process on a particular time
5 line and, at least, some observations about what I thought
6 were fair and appropriate elements of that sale process and
7 the issues in the DIP. I think what I would rather do is
8 give you 20 minutes to confer with the Committee because I
9 don't feel uncomfortable about putting them in awkward
10 position, but it puts me in an awkward position because I am
11 not necessarily going to negotiate this with you in the way
12 that I think I would be about to start in about five minutes.

13 There are a number of issues. I don't know
14 precisely what ones have traction, what ones I am obliged to
15 address and rule upon, what ones are susceptible to
16 resolution. The one thing that I do know is that the
17 Committee and the stakeholders know a lot more about this
18 business and about the process that needs to move forward
19 than I do. While there may not be consensus about that,
20 where consensus can be achieved right and where it can't,
21 then I will provide either ruling or guidance. I think you
22 ought to have that discussion with the Committee. Let's find
23 out where the rubber meets the road and then I can, at least,
24 provide some further guidance to the parties if you need it.
25 Does that sound fair? All right, 20 minutes. Stand in

1 recess. Thank you.

2 [Recess 2:01:15 to 3:04:14]

3 THE COURT: Please be seated.

4 MR. ROSENTHAL: Your Honor, thank you for the time
5 for the parties to meet. There have been discussions going
6 on during the break. Unfortunately, we don't have a deal to
7 report to you. There were discussions about every aspect of
8 the points that you raised in addition to a couple other
9 issues. The parties reached an impasse.

10 THE COURT: Okay.

11 MR. ROSENTHAL: I think we need your help on,
12 particularly on the issues that you raised. There are two
13 other issues that I want to throw into this; one related to a
14 notice of amendment of DIP documents. I think there have
15 been some productive discussions about that. The documents
16 already provide for notice of amendments of material changes.
17 The question has arisen about notices of immaterial changes,
18 particularly as they relate to the ABL lender, which has
19 borrowing based determinations all the time and everything.
20 I think the Committee and the ABL DIP lenders are working
21 through those issues.

22 Then there was an issue raised by Ms. Levine by the
23 no phase II's. So we had a discussion about that. So let me
24 just report on that. So the discussion on the environmental
25 phase II's was everyone is permitted to phase I's. People

1 are permitting to do phase II's, but the Debtors don't want
2 it to be uncontrolled. So we said to them if you want to do
3 phase II's, come to us with a program for which you want to
4 do. I put them in touch with one of my environmental
5 partners that they work out a protocol. We are not paying
6 for the phase II's and everybody seems to be okay with that.
7 So there is a light at the end of that tunnel. I wish I
8 could report a deal, but we weren't able to get there.

9 THE COURT: Okay. What do you want me to do?

10 MR. ROSENTHAL: Well, I think we should make final
11 arguments and then ask the Court to rule.

12 THE COURT: Well, I think I'm at a point where I
13 would be prepared to hear what Silver Point has to say, if
14 they are prepared to relate that. When I asked you to go
15 into the hall with the Committee, it was not necessarily what
16 I expected. I certainly would have welcomed a resolution,
17 but I'm not going to fault anybody one way or the other at
18 this stage for not reaching consensus.

19 A couple folks stood at the podium today and said
20 well, Your Honor, is binary. You can approve the DIP or you
21 can't or you can approve the sale or you can't. This job
22 would be a lot easier if it worked out that way. I have told
23 you that there are elements of the DIP that I am not
24 comfortable with. There are elements of the sale process I
25 am not comfortable with. It doesn't advance the ball for

1 anybody for me to say denied, good luck, try to think of
2 whatever it is I'm thinking of in the future.

3 So I think I am at a point where I would be prepared
4 to hear what, frankly, where the parties are. There are a
5 lot of moving parts, most of which are susceptible to either
6 disposition or resolution. I think I have said,
7 unequivocally, it's my expectation this case will move
8 forward from today, but it has to proceed in a way that it is
9 fair and responsive to the issues that have been raised, not
10 just by the Committee, but by the U.S. Trustee and by the
11 PBGC. I shared with you at least some concepts that I
12 thought would be helpful to the parties to understand. I
13 would be ready to be further advised from the parties. Ms.
14 Levine, do you wish to be heard?

15 MS. LEVINE: Yes, Your Honor. First, Your Honor,
16 thank you for the break. It was productive and we
17 appreciated that. We also under that, at least the last
18 round of the order that we sort of did include the language
19 that was requested by the PBGC. So if that stays, that issue
20 is resolved as well.

21 With regard to the issues that Your Honor talked
22 about right before the break, we heard Your Honor loud and
23 clear with regard to the time line and the Committee will
24 live with that. With regard to the breakup and the expense
25 reimbursement, we still believe that in this particular

1 circumstance it's not really warranted. I don't know whether
2 or not the U.S. Trustee has changed their position on that as
3 well, but right now I think we need Your Honor's help with
4 that.

5 With regard to the unencumbered assets, we heard
6 Your Honor with regard to the avoidance power actions. I
7 think we need Your Honor's help with regard to the 35 percent
8 of the stock and with regard to the Mexican assets. With
9 regard to the lien challenge, we think at one point during
10 the discussions, and we understand it was all or nothing, so
11 it may not still be on the table, but we thought we heard
12 Silver Point say that they would be willing to go to 75. If
13 that is the number, we would be willing to accept it.

14 THE COURT: In terms of days?

15 MS. LEVINE: No, \$25,000.00 for the carve out to \$75
16 for the carve out for the lien investigation. The dates
17 were, I had thought that the dates were revised to June 1st,
18 June 11th, June 15th, 16th and 17th. We appreciated the
19 additional timing and also that the objection deadline now
20 falls after the lien challenge.

21 There was a concept that was talked about with
22 regard to the deposit, taking it down from 10 percent to a
23 flat \$10 million, but if whoever is the either highest or
24 second highest bidder at the auction is not Silver Point,
25 they post or agree to a total of \$15 as a liquidated damage

1 clause for the estate. We thought that was creative and we
2 appreciated that, Your Honor.

3 With regard to the lien items and the budget, the
4 payroll, health and benefit and postage reimbursement, the
5 proposal was made to go to \$7 and a half. We still really
6 don't understand why it shouldn't be \$10 and we think \$10 is
7 market. So we would ask for Your Honor's ruling there. With
8 regard to standing and tolling with regard to a challenge,
9 there is nothing on the table. We think we also heard Your
10 Honor say that that's for another day so we understand that.

11 With regard to amendments to the DIP, we had some
12 conversations, as Debtors' counsel indicated, with the ABL
13 lender. So long as the amendment is favorable to the Debtor
14 and they give us notice, you know, as soon as practical with
15 regard to that that makes sense. We know they are talking to
16 their lender every day with regard to the asset based loan.
17 We do think that with regard to the term loan there should
18 be, if allowed amendments, there should be some ability for
19 us to come into Court and be heard even if it's on an
20 expedited basis, but that hasn't been resolved yet. With
21 regard to the professional fee budget, Your Honor, there
22 doesn't seem to have been any resolution with regard to the
23 Committees' fees. So that is still an open issue.

24 THE COURT: Okay. Mr. Meisler.

25 MR. MEISLER: Thank you, Your Honor. Your Honor, we

1 did make a package proposal that we discussed with the
2 Debtors and we discussed with the Committee, and I will try
3 to do this in an expedited fashion. The time line, Your
4 Honor, you said that was fine and that a breakup fee and
5 expense reimbursement, we reduced our breakup fee from 2
6 percent to 1 percent. On the expense reimbursement, we
7 reduced our ask from 1 and a half percent, which is
8 approximately \$3.7 million dollars to \$1.5 million dollars,
9 which is about a half a percent, which is a cap. We do have
10 to show documentation on our fees and expenses.

11 With respect to credit bidding, Your Honor, we are
12 fine with the way that you mentioned or communicated your
13 observation. With respect to liens on previously
14 unencumbered assets, Your Honor, this one is a very important
15 one to us. With respect to avoidance actions, Your Honor, we
16 were fine with your observation with the caveat that you had
17 recognized, which is the buyer/seller may have views about
18 the avoidance actions on vendors or customers. In our
19 stalking horse bid, we do require any avoidance actions on
20 customers and vendors.

21 You understand the rational for that and so while we
22 are willing to live as the lender without liens on the
23 avoidance actions or the proceeds there of, we would insist
24 upon a standstill with respect to pursuing avoidance actions.
25 This really goes to the Debtors because the avoidance actions

1 are really in their [indiscernible] at this time. We would
2 insist upon a standstill so that no avoidance actions could
3 be brought during a sale process. We would also insist that
4 a buyer have the right to require those as our proposal does.

5 With respect to the investigation budget, Ms. Levine
6 did report accurately that we proposed to increase the budget
7 from \$25,000.00 to \$75,000.00. There are plenty of examples
8 to support a \$75,000.00 investigation budget in case it's
9 much larger than the one --

10 THE COURT: You can live with that?

11 MR. MEISLER: Correct, Your Honor. On the
12 professional fee budget, Ms. Levine did report correctly that
13 we were not willing to change the allocation to the
14 Committee. We were willing to live with your observation or
15 comment that you would not a 506(c) waiver with respect to
16 the Committees' fees and we would live with that. We also
17 understand your reservation of rights that you are not bound
18 to the professional fee budget and that you would look at
19 that professional fee budget and you might allocate
20 differently. We understand that.

21 With respect to attendance at auction, we don't see
22 that as something in dispute. The same with deposit. We
23 don't see that as something in dispute. On the budget
24 variance we did go from a 5 percent on those three line
25 items, payroll, health and benefits and postage. We moved by

1 50 percent.

2 THE COURT: I am deeply religious about the
3 proposition one way or the other. I mean, I said a 10
4 percent variance is typical. I have certainly seen five. I
5 have also seen 15. The issue is less a legal issue and a
6 more practical business issue. If the business is operating,
7 as a general proposition when we tie these things into a
8 budget, neither the Debtor nor, frankly, I want a structure
9 that is created for what I would call non-material defaults
10 to be triggered with some regularity. So what is the
11 relationship between these two particular line items that
12 requires them to be treated differently from all others?

13 MR. MEISLER: Sure. So we think that those items,
14 in particular, should be very easy to forecast. They should
15 be fairly fixed numbers and, therefore, we think that there
16 should be tighter governments on those particular line items.
17 Now, unlike what Ms. Levine articulated, if the business is
18 going gang busters, we are going to be thrilled. We would
19 absolutely be thrilled if payroll increases because people
20 are being paid overtime because there is more product being
21 sold. That is not our concern. Our concern would be that
22 for whatever reason, money is going out the door to pay
23 employees that has not been approved. So people are getting
24 bonuses, they are getting stay bonuses that have not been
25 approved by Your Honor.

1 THE COURT: Well, that's not going to happen. I
2 mean, Mr. Rosenthal is going to leave in handcuffs if that
3 sort of thing happens. That was a joke. It will be Nestor.
4 It would be Mr. Nestor. All right, I understand. That is
5 the kind of thing I am reluctant to get, sort of, into the
6 weeds on, but I have to say that that's not that compelling
7 an explanation. The reason is this, again, while I think
8 everybody and your plan has as much of a reason as anybody to
9 hope that the business is doing great and going gang busters,
10 but nobody has explained to me, we are not going to see a
11 bonus program that is going to send material dollars out the
12 door unless Mr. Kenny sees it, Ms. Levine sees it and I see
13 it. If we have got people working over time because we have
14 got lots of work, then that is something that seems like a
15 high class problem.

16 The issue is this, I understand the Committees'
17 point. I don't want to set the Debtor up for some sort of
18 default issue here and the fact that it's been sort of
19 focused on is what's got my attention to it. The idea that
20 money, well, money goes out the door all the time; that's
21 what a budget is. So I am not understanding why this would
22 be a different issue than any number of other items, you
23 know, taxes or other stuff that, you know, again, we budget
24 with a high level of confidence, but one of the reasons I
25 have a job is because not all budgeting is perfect and so

1 here we are.

2 I need a little more guidance on that. That seems
3 to me like a small issue. We are two and a half points apart
4 on this issue. I don't really feel strongly about it one way
5 or the other, but if it's becoming this sticking issue, it
6 seems to me that would give me a bell going off that this is
7 going to turn into an issue. In front of me, either with the
8 default practice or something else. So I guess I need
9 comfort or guidance on where we are going with this part.

10 MR. MEISLER: Your Honor, I think we have a
11 heightened sensitivity as the lender because we are the money
12 lender. We have concern about how our money is being used.
13 We seek credit risk. So every dollar that gets spent on this
14 DIP is another dollar that's ahead of our prepetition loans.
15 That also goes to the issue, it fits nicely with the
16 unencumbered asset issue.

17 Your Honor, we don't believe that the value of the
18 unencumbered assets is going to be sufficient to cover the
19 DIP loans. We don't believe it. Let me parse that even
20 finer. We don't believe that the value of the unencumbered
21 assets is going to be sufficient to cover the new money
22 portion of the DIP loans. So, Your Honor, we have heightened
23 sensitivity with respect to the Debtors spending money and we
24 are supportive of the Debtors in the way they are operating,
25 but that's the reason for our ask that there be certain

1 governors and there was heightened sensitivity, as mentioned,
2 to certain of these three line items.

3 THE COURT: Can you remind me, I thought its
4 postage, its employee wages.

5 MR. MEISLER: And health and benefits.

6 THE COURT: Health and benefits. Can you remind me
7 of the default mechanism here, what is the notice period? Is
8 it three days? Is it five?

9 MR. MEISLER: There are five days.

10 THE COURT: I know there is a revised version of the
11 order.

12 MR. MEISLER: That has not changed.

13 THE COURT: That has not changed, okay. All right,
14 I understand.

15 UNIDENTIFIED SPEAKER: I have a couple comments on
16 it.

17 THE COURT: Okay.

18 MR. MEISLER: Your Honor, do I need to add any more
19 clarification? I know Ms. Levine mentioned the assets of
20 Mexico and maybe there was certain other.

21 THE COURT: I understand.

22 MR. MEISLER: You do understand, terrific.

23 MS. LEVINE: Your Honor, there are two comments. I
24 just wanted an opportunity to respond to them.

25 THE COURT: Sure and then Mr. Rosenthal can respond.

1 MR. MEISLER: Your Honor, my colleague just
2 mentioned to me that for clarity, also, I realized I skipped
3 a notice. The Committee does get notice of amendments. We
4 are not offering an opportunity to object because with
5 respect to non-material modifications, well, they are just
6 that, they are non-material modifications. For example, we
7 just amended the DIP creditor agreements because we had a
8 milestone of April 10th as the date that the sale procedures
9 order must be entered and April 12th that the final DIP
10 financing order must be approved and entered.

11 THE COURT: But didn't I just hear from Mr.
12 Rosenthal that that modification also contemplated then a two
13 point bump in the terms of the --

14 MR. MEISLER: Your Honor, that's a material
15 modification and that's not the term lenders; that's the ABL
16 lenders amendment. That is a material modification and I put
17 that in a completely different bucket than non-material
18 amendments. Thank you, Your Honor.

19 THE COURT: Ms. Levine.

20 MS. LEVINE: Your Honor, just two points. With
21 regard to the lien on avoidance actions, it sounds very
22 reasonable to say just toll them. Frankly, the Committee
23 really has no intention to be suing vendors or customers
24 during any point in time prior to the sale, but the challenge
25 period expires in advance of the sale and avoidance,

1 technically, Chapter 5 causes of action might be the kinds of
2 causes of action that would come into play there as well. So
3 we really truly believe that avoidance actions have no place
4 as part of the lenders collateral and we have had
5 conversations with the Debtor about we are not contending to
6 do anything --

7 THE COURT: I think your comparing apples and
8 oranges. I don't believe that what Mr. Meisler just
9 described as a limitation on the Committee's ability to
10 pursue its investigation and to file whatever it believes is
11 appropriate in the context as a result of that investigation
12 prior to your expert. I think, what I understood as comments
13 to be was he does not want Chapter 5 causes of action filed
14 against parties that are likely to be the sorts of vendors or
15 customers that are a sensitivity issue. I think that's a
16 fair clarification. I mean, otherwise, the idea that a
17 Chapter 5 tolling would somehow impair your ability to move
18 forward, that doesn't seem consistent with what we are
19 talking about. Mr. Meisler, have I fairly characterized your
20 comments?

21 MR. MEISLER: Yes, Your Honor.

22 THE COURT: Okay.

23 MS. LEVINE: We agree that we have no intention of
24 brining any of the case type, the actions during this period
25 of time as well. So that is not really an issue.

1 THE COURT: I think it's a fair point though.

2 MS. LEVINE: The 506(c) waiver, if I heard counsel
3 correctly, what he is saying is that he understands that
4 there is not going to be any 506(c) waiver with regard to
5 Committee counsel fees. We are not asking for that. We are
6 asking that there be no 506(c) waiver.

7 THE COURT: That was my understanding and that was
8 my observation. Mr. Rosenthal.

9 MR. ROSENTHAL: A couple points. We just clarified
10 one on the avoidance actions. I think the way it was said is
11 exactly how the Debtor believed it would transpire and not
12 intended to be any limitation on the Committees' challenge
13 right. I do want the Court to know that this amendment to
14 add the 2 percent, I did talk to Ms. Levine about it as soon
15 as it came up on Wednesday or Thursday, but we did have to
16 get this done before Friday.

17 The last point, Your Honor that you had had some
18 discussion about was the increase in the variance from 5 to 7
19 and a half percent. So, I just spoke a little bit with Mr.
20 Carmody. We thought 5 percent was very tight, but we think
21 we could have lived with. Seven and a half percent gives us
22 a little more variation. We do not think that as a business
23 matter, given where we are now and for the next months until
24 the closing that this is likely to be an issue on these
25 particular line items. The business is doing well, but it's

1 not flourishing, if you will, it's not increasing
2 substantially. We don't think that there will be a
3 significant deviation.

4 THE COURT: Independent of Mr. Carmody going on a
5 frolic and detour and starting to hand out money and giving
6 this to people.

7 MR. ROSENTHAL: Mr. Carmody is not going to be
8 leading me to jail or visiting me in jail. We are not going
9 to be making any payments to employees other than as approved
10 in the wage order or any subsequent, you know, bonus.

11 MS. LEVINE: Our point is slightly different and
12 maybe this will resolve it, but --

13 THE COURT: We need you on the transcript.

14 MS. LEVINE: Sorry. The concern that we have is
15 that we understood that under payroll also comes commission
16 salesman. The commission salesman are not operating under
17 non-competes. So they can take their relationships and go,
18 and if there is a concern that the commissions are not going
19 to be paid or paid timely, that was what caught our interest
20 with regard to this particular variance limitation.

21 THE COURT: I would be hard-pressed, and Mr. Meisler
22 is going to stand up and agree with me, I would be hard
23 pressed to believe that an outfit that wasn't to purchase
24 this company wants to put those relationships at risk.
25 Again, I am trying to figure out exactly what it is about

1 this that makes it fall into a different category then all
2 other budget line items. Again, to the extent that there
3 were a default, as it's currently described, even if the
4 default were called, right, the Debtor would be in here in 24
5 hours and I would tell Silver Point that they have a high
6 class problem. That, you now, business is good and we are
7 paying our employees.

8 MS. LEVINE: Your Honor, this horse may be dead.

9 THE COURT: Also, aren't the commissions presumably
10 factored into the budget?

11 MR. MEISLER: Yes.

12 THE COURT: They should be.

13 MS. LEVINE: Right, our point was that if they had a
14 really good week, then there was going to be more of a
15 variance on the upside, in a good way, and they were going to
16 have to pay more commissions then we would be within the line
17 item. Your Honor, this horse may be way dead. Our concern
18 was that it looked to us like it was going to discourage
19 people from selling and depressed value. We didn't want
20 that, but I think that we have clarified that that's not
21 going to happen.

22 THE COURT: Yeah, if that's not going to happen, all
23 right, a couple of things. First, with respect to the 7 and
24 a half percent, what I have heard from the Debtor is that
25 they believe they can live with it. It doesn't not seem to

1 me that it is likely to create a default because the
2 variance, it seems to me, would be typically associated with,
3 frankly, positive business developments. If not, and a
4 default is called associated with this, you know, I will be
5 here, but I am not going to micromanage the mechanics of the
6 budget on that line item.

7 With respect to the points raised, again, I really
8 appreciate everybody's colloquia on this in order to try to
9 reach as much of a business resolution as possible. We are
10 down to a series of short strokes. With respect to the issue
11 of the liens on previously unencumbered assets, I will
12 authorize that. We have answered the question with respect
13 to avoidance actions. It's not my expectation that routine
14 or typical Chapter 5 avoidance actions would be commenced, so
15 I think that there is an understanding that there is
16 stability to the business; that's what we are talking about.

17 Any sort of standstill, I don't think it's tolling
18 because we're not looking at the statute of limitations or
19 anything else at this point, but to the extent that there is
20 a standstill or an agreement that Chapter 5 causes of action
21 are not going to be commenced, I think that's consistent with
22 how I would expect this case would be proceeding anyway.
23 With respect to the Committees' investigation and whatever it
24 is they are going to do, the concept of a standstill has no
25 effect on a Committees' ability to perform its investigation

1 and to act as it deems proper.

2 With respect to the breakup fee, I will not approve
3 a breakup fee. I understand and I appreciate the
4 accommodation and the reduction, but I am not prepared to
5 approve a breakup fee in the context of these proceedings.
6 For reasons largely stated by the Office of the United States
7 Trustee, I am not satisfied that it's either appropriate or
8 necessary to incentivize Silver Point to take this initial
9 step. I am sensitive to the issue. It is clearly well within
10 the range of what this Court has previously approved as a
11 breakup fee, but, again, these percentage amounts are
12 significant sums in large cases.

13 We have held and observed in other cases that the
14 percentage, while we typically have a cap of 3 percent, when
15 we look at this as a percentage, that percentage is of less
16 utility in a larger, larger case. An amount of the better
17 part of \$3 million dollars as a breakup fee, here, to me is
18 both chilling and, again, on the record before me not
19 sufficiently warranted to approve for an entity in the
20 position of Silver Point.

21 With respect to the expense reimbursement, I will
22 approve an expense reimbursement of \$1.5 million dollars. I
23 have generally treated expense reimbursements as being
24 different from breakup fees. Again, the tradition or the
25 practice is that they are subject to documentation and are

1 capped, in this case, at \$1.5 million dollars. It's clear to
2 me that even with an incentive to participate and engage in
3 this exercise, sufficient that a breakup fee is not
4 warranted, there are material expenses that have been
5 incurred by Silver Point and are being incurred. So an
6 expense reimbursement of \$1.5 million dollars, I'd be
7 prepared to approve and authorize.

8 As I said with respect to the liens on previously
9 unencumbered assets, I will allow them. I understand the
10 Committees' concern with respect to them, but it is not
11 unusual for a DIP finance lender to require or look to
12 unencumbered assets in order to secure its post-petition DIP
13 financing extensions.

14 With respect to the professional fee budget,
15 consistent with my practice, I'm not going to plug a number.
16 I will observe that I think in comparison with the amounts
17 that are being charged and budgeted for by the estate
18 professionals that these numbers are clearly light and based
19 upon that I will not approve or authorize a Section 506(c)
20 waiver. That waiver does not extend simply to fees, but it
21 does extend to simply a right to pursue a Section 506(c)
22 surcharge if circumstances warrant at the appropriate time.

23 It's my belief that the parties have agreed on an
24 investigation budget of \$75,000.00; that seems fair to me and
25 appropriate. As I said, I will allow the budget with the 7.5

1 percent variance as it relates to postage, payroll and health
2 benefits. I do share the concerns that have been expressed
3 by the Committee and, frankly, by the Debtor that on a week
4 to week basis that much of a swing is still pretty tight, but
5 I am going to assume that the intention is to allow the
6 process to play itself out and to provide, frankly, a lender
7 a measure of comfort and control over moneys that are going
8 out.

9 The interplay of things like commissions, which are
10 different from bonuses; commissions I regard as more routine.
11 So those commissions could swing one way or the other. What
12 I expect is that the Debtor will have a handle on their
13 financial forecasting and they will be as good and accurate
14 as they can be. If there are issues with respect to that, I
15 am not difficult to find. I think that that covers the
16 various items that remained in dispute. I know that we had a
17 discussion about the time line, which I think I have approved
18 and authorized. It's my expectation that counsel will be
19 able to reach agreement with respect to the dates going
20 forward and I think you have already done so with respect to
21 objections and otherwise. Mr. Rosenthal.

22 MR. ROSENTHAL: Just to make sure we have covered
23 everything, so, Your Honor, avoidance actions are not subject
24 to the DIP liens that --

25 THE COURT: Avoidance actions are not subject to the

1 DIP lien.

2 MR. ROSENTHAL: Correct, but the other unencumbered
3 assets are. Got that. We talked about the deposit, the \$10
4 million, plus the \$5 is fine, I assume.

5 THE COURT: I am fine with that. You know, the
6 testimony, I don't think was really controverted. The issue
7 is this and, again, I would largely defer to the financial
8 advisors. They seem to be a little bit at logger heads. Ten
9 percent is a typical number, but these percentages become
10 material, but I think that, again, what has been proposed as
11 a smart and elegant way to deal with that issue in order to
12 maximize the ability for parties to step up without having to
13 pony up and tie up \$38 million dollars.

14 MR. ROSENTHAL: We believe it's large enough to
15 represent a sizeable investment that no one would want to
16 walk away from. If they are chosen as the stalking horse, I
17 mean as the successful bidder or the backup that goes to \$15.
18 Of course, one of the factors that we will be evaluating with
19 any bid is credit worthiness. I believe we have all of the
20 issues that were raised by the Court and, frankly, that are
21 still open. What we would need to do is put these changes
22 through the --

23 THE COURT: If parties want an opportunity to
24 confer, obviously, we would need to deal with the form of the
25 order and close the loop on that. There are other items and,

1 obviously, certain of these issues are not necessarily agreed
2 to by Silver Point and I understand, [indiscernible], it's
3 good to see you again. So, I understand that we may need a
4 moment on that, but I do, as I said, have a 4:00 stop and we
5 have a couple other items.

6 MR. ROSENTHAL: Why don't we just go to the other
7 items now and while that's occurring, I think the discussions
8 can take place. Different folks are handling those.

9 THE COURT: Okay.

10 MR. ROSENTHAL: Your Honor, we do want to, as part
11 of the record, introduce the DIP amendment, which revises
12 some of the dates and also increases that 2 percent.

13 THE COURT: Okay.

14 MR. ROSENTHAL: May I approach?

15 THE COURT: Yes. Thank you. Any objection to the
16 admission of the amendment? It's admitted.

17 MR. ROSENTHAL: All right, Your Honor, I'll turn it
18 over to Jeremy Graves.

19 MR. GRAVES: Good afternoon, Your Honor, Jeremy
20 Graves, Gibson Dunn & Crutcher on behalf of the Debtors. I'm
21 here in support of entry of final orders on three of the
22 Debtors' first day motions. These are going to be agenda
23 items 4, 5 and 6 in your binder. That's the cash management,
24 critical vendors and the Debtors' NOL preservation motion.

25 In connection with our reply on Friday, we filed

1 revised versions of the final orders approving each of these
2 motions. For each, the Committee had objected. My
3 understanding from Ms. Levine is that they are no longer
4 intending to prosecute those objections.

5 MS. LEVINE: Your Honor, with regard to the NOL
6 motion, the critical vendor motion, we are not sure why they
7 don't want to give us notice, but we are withdrawing those
8 objections and we will just confer with the Debtor on an
9 ongoing basis. With regard to the cash management issue,
10 because of the issues with regard to the DIP, we do want
11 reporting with regard to what cash is going between the
12 Debtors and to non-Debtors, the back and forth between the
13 various entities.

14 THE COURT: I saw the Debtors response on that and I
15 guess I would like some closure in whether we can achieve it
16 right now or otherwise. The Debtors response was along the
17 lines of this disclosure would be stuff that we are not
18 typically creating or sharing and that will be a substantial
19 burden. Do I grasp that?

20 MR. GRAVES: That's correct. If you read the
21 Committees' objection, they ask for a litany of items,
22 reporting on this and that. If the question relates to a
23 reporting of cash transfers as between the U.S. Debtors and
24 the Mexico Debtors, which I believe is probably the crux of
25 the issue, I don't think that we would have a problem

1 providing the reports of those cash transfers. We could work
2 with language.

3 MS. LEVINE: That would be fine, Your Honor.

4 THE COURT: Okay. I think, again, my approach to
5 this sort of thing typically is that a Committee is entitled
6 to, you know, information, but as a general proposition the
7 goal is to have it be information that the Debtor is
8 typically preparing so that we are not creating a chore for
9 some guy in the treasury department who already has enough to
10 do. If that works, that's fine.

11 Another observation that I would make is, and again,
12 I don't think I need to tell anybody this, but if there are
13 issues with respect to discovery, sharing of information,
14 process going forward, that sort of thing, I strongly
15 discourage motion practice and letter practice relating to
16 that stuff. If you have issues with respect to who is
17 getting what, who is being frozen out of the process, what
18 the schedule for different items are, you ought to get me on
19 the phone. We can usually cut through things. As we have
20 said, you know, the Committee has observed that this is a
21 large transaction with a fairly tight time line. I am not
22 interested in a lot of handling back and forth about, you
23 know, who did what, but keep the ball moving.

24 MR. GRAVES: Thank you, Your Honor. I think that
25 works. I think, to be fair, our disagreement is really to

1 objection rights and not notice rights. I think that we do
2 intend to provide substantial notice on each of these matters
3 to the Committee. So they will, I'm sure, get you on the
4 phone if necessary.

5 THE COURT: I think that's fine, but I think with
6 that resolution on the record, then, it sounds like those
7 three items should be resolved, am I correct?

8 MR. GRAVES: I believe that is correct.

9 THE COURT: All right, does anyone else wish to be
10 heard to each of those items 4, 5 and 6 on the agenda? Very
11 well. Do you have clean amended orders?

12 MR. GRAVES: Your Honor, I have clean orders on the
13 critical vendors and the NOL. I will be happy to hand those
14 up. I may need to work just a little on the language of the
15 reporting and the cash transfers with the Committee and the
16 cash management just to make sure it's agreed on.

17 THE COURT: That sounds fine. I will take that
18 under certification at your convenience.

19 MR. GRAVES: May I approach?

20 THE COURT: Sure. Thank you. Very good.

21 MR. GRAVES: Thank you, Your Honor. I will cede the
22 podium to Mr. Newman.

23 THE COURT: Very good.

24 MR. NEWMAN: First time I am going to stand up and
25 say something.

1 THE COURT: Yes, sir.

2 MR. NEWMAN: I want to tell you how much we
3 appreciate the fact that you are available all the time. You
4 made that speech to us at the first hearing and you have made
5 it again to us. We had, as you can expect, a fairly
6 extensive discovery regime going over the past 10 days and I
7 don't believe you got a call.

8 THE COURT: I did not and you get full credit for
9 that. You don't need to call me just to tell me your
10 working.

11 MS. LEVINE: Your Honor, one housekeeping matter
12 that's on the record because we don't want to be in violation
13 of anything. The Committee filed a motion to seal only
14 because some of the information that was produced to us was -
15 -

16 THE COURT: I signed that.

17 MS. LEVINE: Okay. Thank you.

18 THE COURT: Mr. Nestor, I would ask tomorrow, if you
19 would have somebody just audit the docket and make sure. I
20 believe I have signed the CNO's. I know that I have signed
21 the sealing issue. So if there is anything missing, just
22 give us a call and we will get it on the docket. Yes, sir.

23 MR. NEWMAN: Your Honor, thank you. A couple of
24 things. A housekeeping matter, number 19 on the docket was
25 the order, the motion seeking leave to file on those replies.

1 THE COURT: Okay.

2 MR. NEWMAN: May I approach?

3 THE COURT: Sure.

4 MR. NEWMAN: Sam Newman with Gibson Dunn on behalf
5 of the Debtor. A couple other items. One is number 14, which
6 is the order seeking, an application seeking to employ
7 Lazard. There were substantial negotiations over the terms
8 of that, if I may approach with a revised order.

9 THE COURT: Great.

10 MR. NEWMAN: Just quickly paragraph 4 on page 2,
11 change relating to the payment expectations with respect to
12 financing transactions and the revised agreement agreed that
13 no transaction fee would be approved under the DIP and then
14 certain other modifications were made, which were run by the
15 Committee. I think everyone is in agreement. Similar change
16 in paragraph 7.

17 THE COURT: I see it.

18 MR. NEWMAN: And 9.

19 THE COURT: Okay. All right, does anyone else wish
20 to be heard with respect to the Lazard retention? Very well.
21 I have had an opportunity to review the revised version and I
22 will approve and authorize the relief.

23 MR. NEWMAN: Great. Then I would like to next call
24 number 7, which is the final order regarding employee wages.
25 There is one objection from Volt and I'll leave that to call

1 the matter with respect to Volt's objection and request for
2 consent.

3 THE COURT: Sure. Yes, sir.

4 MR. SWEENEY: Peter Sweeney with Blakeley LLP for
5 Volt Consulting. We had reached a resolution on number 7 to
6 reserve our rights to argue the amount of the claim and to
7 reserve our rights whether to require payment. So we will
8 reserve those rights for later so that they can go forward
9 with the rest of the motions.

10 THE COURT: Okay.

11 MR. NEWMAN: So we would ask that the Court approve
12 the order as blacklined and just note the stipulation on the
13 record that Mr. Sweeney can appear at the next omnibus or
14 thereafter to request any relief he deems appropriate with
15 respect to his client.

16 THE COURT: That sounds fine. Does anyone else wish
17 to be heard with respect to the final order regarding
18 employee wages? Very well. With the stipulation noted on
19 the record, I will approve and authorize the relief. The
20 order will issue.

21 MR. NEWMAN: Then we would also ask Your Honor to
22 call number 18, which is Mr. Sweeney's application for relief
23 from stay, which I will let him speak to and I believe we are
24 continued to the 12th.

25 MR. SWEENEY: That's right, Your Honor. We have

1 agreed to continue to the 12th. We have been working with the
2 Debtors on this motion and since the 30th we were under the
3 understanding that we were going to get some sort of payment
4 plan on the prepetition debt. We have been having e-mails
5 back and forth through the 6th, but we didn't really realize
6 that we were going to go forward today until the notice of
7 agenda came out. We have agreed to the continuance until the
8 5th. Then we also heard today about the lack of liquidity
9 about the prepayment. So we are still learning about that
10 and we will see if we can reach some of resolution. If we
11 need to, we will go forward on the 12th.

12 THE COURT: Very good. Thank you.

13 MR. NEWMAN: Your Honor, that's all that I have.
14 Thank you.

15 THE COURT: That's all the items that we have on the
16 agenda. Mr. Rosenthal, where do we stand?

17 MR. ROSENTHAL: Well, how would you like to do this,
18 Your Honor? We, obviously, have to go back and markup the
19 various orders; however, we do have some changes that I could
20 walk you through now. Mr. Nestor, does the judge have the
21 last blackline?

22 THE COURT: I don't know that I have the last
23 blackline. I got a lot of paper from you all.

24 MR. ROSENTHAL: Would you like me to walk through
25 the changes to this point or would you like us to go back and

1 give you a consolidated markup?

2 THE COURT: Why don't we do this; why don't you give
3 me the blacklines. So, I don't think there is a reason to
4 walk, I think we can more efficiently use our time. I will
5 review these in chambers. I would encourage the parties to
6 go back and confer on final forms of the order, consistent
7 with the rulings and agreements that have been made. Then I
8 would entertain them under certification. If issues remain
9 with respect to them, I will not be easy to get on the phone
10 tomorrow, but I would, if it boils down to it and if you need
11 me, I would find time.

12 MR. ROSENTHAL: We do need an order by the 15th.

13 THE COURT: Right, you will get me on the phone at
14 some point tomorrow if you are at logger heads on the forms
15 of the order, but I have a couple different matters, I have
16 RadioShack and I am not sure what is coming with them. They
17 tend to show up and they just don't leave.

18 MR. ROSENTHAL: I think there is a commercial about
19 that.

20 THE COURT: Well, their back. So I think I will
21 take these under advisement. The blacklines will give me a
22 sense of at least where the parties stand right now. If
23 issues arise, you can get me on the phone, but, otherwise --

24 MR. ROSENTHAL: May I give you one more blackline,
25 the sale procedures blackline.

1 MR. MEISLER: Mr. Rosenthal, before you go to the
2 sale procedures, Your Honor, if I could just flag that the
3 Debtors and Silver Point are still working on the carve out.
4 I would classify that as more of a company change because we
5 are just trying to make sure that the numbers works with the
6 budget. So you will see that number fluctuate.

7 MR. ROSENTHAL: There are concepts of wind down
8 amount and carve out cap. They are mathematical and tied to
9 the budget.

10 THE COURT: I will leave that where it is. I will
11 let the parties have that discussion and, again, if we need
12 to confer, we can. You mentioned, Mr. Rosenthal, and I did
13 see that there is \$8 plus million on a post-sale basis to
14 move this process forward. Let me at least share with you,
15 this is not a today issue, but I think it is worth
16 understanding now. I think some of my colleagues have rules
17 about or practices relating to sale cases that are hard and
18 fast about where we go from the sale. I don't know how this
19 process plays out in this case and I don't have a firm rule.

20 I will tell you this that I strongly prefer plans in
21 Chapter 11 cases where possible. Certainly, sale cases that
22 lead promptly to a 7, sort of as freefall or to a structured
23 dismissal or even just a dismissal are typically less than
24 ideal for reasons you don't need me to go through. What I
25 would share with the parties and I don't think this is

1 inconsistent with what my colleague downstairs, Judge Carey,
2 mentioned the other day is that to the extent that the sale
3 process plays itself out and the Debtor is basically then,
4 promptly, in a liquidation scenario, proceeds are in or
5 litigation needs to be pursued or something else.

6 Having expressed that my preference is for a plan,
7 in many cases I have encouraged parties to get there as
8 cheaply and as promptly as possible. I have encouraged and
9 approved combined plan and disclosure proceedings. The
10 mechanism to get to that stage can seem daunting from where
11 you stand. You know a lot more than I do, particularly even
12 in a post-sale scenario. So it may seem simple to me and if
13 it doesn't I will be driven by your judgement, but I would
14 ask that the parties, as you figure out where this case is
15 going, and where that process plays out and what the end game
16 is, I would at least share with you what my preference is.

17 Again, to me, I have seen a number of cases where
18 it's been, I think, better for the administration of justice
19 and for the interest of stakeholders that we have done these
20 just relatively simple structures, under liquidating plan
21 scenarios that, you know, the associates in this room right
22 now have a drawer about this big filled with them that they
23 could turn in by 4:00 today. To me, that, again, is
24 something that is not just better, doesn't necessarily help
25 my numbers at all, but I do think that it's an appropriate

1 way to try to wrap up these cases.

2 When you talk about a wind down budget and that sort
3 of thing, that does seem to me to be consistent with an
4 understanding that there needs to be a path forward from the
5 sale other than, you know, just lighting a match to it. So
6 I leave that as just an observation. It's the kind of thing
7 also that may factor into some of the discussions that will
8 be leading up to the sale process.

9 MR. ROSENTHAL: Thank you, Your Honor. We
10 appreciate that. We had actually been discussing that with
11 the Young Conaway folks.

12 THE COURT: You just got to tell me you're ahead of
13 me, right?

14 MR. ROSENTHAL: I'm not ahead of you. They had head
15 that this was coming down from the Delaware Courts. I think
16 that is our sense right now. I don't really see a benefit to
17 a conversion. I don't really want to go to dismissal. It
18 seems like a simple plan might be the way to go. We
19 definitely are taking that under consideration.

20 THE COURT: Very good. All right, then I will look
21 for orders under certification and if need be, I will take
22 the other blackline and if need be, I would be available at
23 some point tomorrow if the parties do, in fact, reach an
24 impasse. We will stand in recess and I appreciate everyone's
25 time.

1 MR. ROSENTHAL: Thank you, Your Honor.

2 THE COURT: Thank you.

3 (Court Adjourned)

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CERTIFICATE

7

8 I certify that the foregoing is a correct transcript from the
9 electronic sound recording of the proceedings in the above-
10 entitled matter.

11

12 /s/Mary Zajackowski
Mary Zajackowski, CET**D-531

April 13, 2015
Date

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